Budgetary Policy

To what extent does budgetary policy realize the goal of fiscal sustainability?

41 OECD and EU 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.

Chile

Score 10

Chilean budgetary policy has been very successful in terms of national debt reduction and reserve fund accumulation. The country’s budgetary policy is based on a fiscal rule that explicitly – and relatively transparently – links overall government spending to an estimate of government revenue trends. This puts Chile at the international best-practice frontier regarding budget policies and fiscal regimes. Although temporarily suspended during the difficult 2009 – 2010 period, this rule’s application since 2001 (and the adherence to fiscal orthodoxy even without comparative legislation since the mid-1980s) has allowed the government to reduce overall debt, accumulate sovereign wealth and reduce its overall financial liabilities to negative levels. This policy proved absolutely adequate in dealing with the global financial crisis. In order to improve fiscal transparency and the validation of the public balance, the Fiscal Consulting Council (Consejo Fiscal Asesor) was created in 2013.

Citation:
Cf. DIPRES, Política de Balance Estructural: http://www.dipres.gob.cl/594/w3-propertyvalue-16156.html

Estonia

Score 10

Estonia has followed strict fiscal policy for decades. Every effort has been made in order to maintain a balanced state budget in times of economic recession. As a result, the country has the lowest debt as a percentage of GDP in Europe and is able to meet future financial obligations without putting an extra burden on future generations. Yet, maintaining a balance budget
has come with some costs. The government substantially cut municipal budgets in 2010 – 2011, and many local governments have been struggling with budgetary debts and insufficient resources.

Finland

Score 10

According to the Government Program, Finland’s economic policy goals are to strengthen the economy’s growth potential, to raise the employment rate, to bolster household spending power, and to improve international competitiveness. The government’s commitment is to an active fiscal policy that supports economic growth and employment, and by and large, the impact of an unfavorable economic environment notwithstanding, the government has been able to promote its goals and ambitions. While the debt crisis in Europe has slowed economic growth, Finland has kept its budget deficit in line with European Union rules, and the government seeks to halt the growth of debt by 2015 to secure its top AAA credit rating. Comparatively speaking, prospects are fairly good. While government debt in 2012 was considerably higher than in 2008, according to the European Commission, debt was still much less than the average government debt in the euro area. The government reviews annually the need for additional fiscal policy adjustments; as of the review period this starts from the decision over central government spending limits for 2013 – 2016.

Norway

Score 10

The Norwegian government has received a large flow of financial resources from the extraction of petroleum since the 1980s. This income is projected to remain substantial until around at least 2040, and in the case of natural gas, probably longer. Gas has now passed oil as the most important source of income, and the production of oil has been in decline during recent years. It is expected that by 2025 there will be a significant drop in revenue generated from the petroleum sector, requiring significant budgetary changes. 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 the 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. This is today designated as a pension fund. The fund is administered by Norges Bank Investment Management (NBIM), an arm of Norway’s central bank, and invests exclusively in non-Norwegian assets. Under current rules, the government is required to invest all petroleum revenue in the fund. Each
year, at most 4% of the fund’s value is made available for current expenditure. This principle is supported by all political parties except the populist Progress Party, but has no constitutional protection. Including the petroleum fund, the Norwegian government’s net asset position amounts to about 120% of GDP. This surplus is sufficient to cover outstanding and future pension liabilities, putting the country in a unique position relative to most other Western countries. However, the increased divergence between the petroleum-based economy and the remainder has been a source of concern.

Sweden

Score 10

Since the mid-1990s, fiscal and budgetary discipline has been extraordinarily strong in Sweden and its tight budgetary regime is beginning to pay off now.

Since the 1992 financial crisis, maintaining sound fiscal policy has been an overarching policy goal for both center-right and Social Democratic governments. As mentioned, Sweden is one of very few countries with a budget surplus goal, and although increasingly controversial, neither government nor opposition harbor any plans to abolish that goal. This goal and other elements of the fiscal policy framework has set Sweden on a trajectory of strong and sustained economic development. Not even the 2008 global economic crisis or the euro crisis have caused any major disruptions to Sweden’s economy.

The current center-right government is fiscally conservative. With general elections looming in 2014, some commentators expect public spending to increase next year. For now, suffice it to say that Swedish fiscal policy remains highly sustainable.

Citation:

Switzerland

Score 10

Budgetary policy in Switzerland is fiscally sustainable. Gross public debt (general government) started to increase in the mid-1990s from a low level of 38% of GDP to reach a peak of 58% in 2004, but had receded to 39% by 2013. Structurally adjusted budgets were balanced even during the crisis of 2008 – 2009.

This fiscal sustainability is mainly due to the political decision to have a low tax load and a lean state. In addition, keeping the public deficit and debt low
has been a major concern of politicians at all levels of the political system. Various rules and means have been developed in order to avoid the dynamics of expanding budgets. For example, on the federal level, there is the constitutional debt brake (Article 126, Article 159): “The maximum of the total expenditures which may be budgeted shall be determined by the expected receipts, taking into account the economic situation.” Direct democracy offers another effective means of keeping the budget within limits. In popular votes, the people have proven reluctant (compared in particular to members of parliaments when elections are drawing near) to support the expansion of state tasks with a corresponding rise in taxes and/or public debt.

Even taking into account the fact that some individual cantonal and municipal governments do pursue unsustainable budgetary policies, the total (i.e., general government) budgetary policy achievement arguably puts Switzerland in the OECD’s top group in terms of fiscally sustainable national policies.

Bulgaria

**Score 9**

Over the last 15 years Bulgaria’s budgets have been very reasonable and its budget position is sustainable. In eight of those years the government generated surpluses, especially in the period of the positive swing of the business cycle in Bulgaria in 2004 – 2008. The GERB government in 2009 – 2013 was successful in maintaining fiscal discipline. In 2009, the year when Bulgaria’s economy took the full hit of the global economic crisis, the budget went into a deficit of 4.3%, but was swiftly brought down to 0.8% in 2012. Since the late 1990s, Bulgaria has brought down its public debt from levels above 100% of national income to less than 20%. The debt service is a negligible burden for the annual budget, and the country has been very successful in using both the domestic and international bond markets to control the flow of this service.

Denmark

**Score 9**

The global economic crisis resulted in a dramatic shift in public finance from surplus to deficit. The economic crisis’ depth and the strong automatic budget reaction account for the shift. (Denmark has the strongest automatic stabilizers within the OECD.) On top of this, Denmark has also pursued an expansionary discretionary policy to mitigate some of the consequences of the crisis.
One consequence of the crisis has been that Denmark’s public finances have violated the norms of the Stability and Growth Pact, and it has been an overriding policy concern to bring public finance in accordance with EU recommendations. This includes bringing the budget deficit below 3% of GDP and improving the structural balance by 1.5 percentage points of GDP over the period 2010 to 2013. Current projections and assessments indicate that these targets will be reached. The deficit for 2012 was 4.1% of GDP and was thus in violation of the 3% budget norm, but it is explained by the repayment of individual contributions to the early retirement program as a consequence of a structural reform of this scheme. The deficit for 2013 and 2014 is projected to be about 1.5% of GDP.

Denmark had already taken initiative to introduce a budget law with expenditure targets, which is now an element in the fiscal compact in the European Union.

The overall status of Denmark’s public finances is rather strong. Gross debt was by the end of 2012 was 45% of GDP, while net-debt was only 7% of GDP. Recent assessments show that current policies satisfy the conditions for fiscal sustainability. This is mainly the result of reform undertaken over recent years to increase the retirement age (both early retirement and public pensions), to reduce the early retirement period (from 5 to 3 years) and various other reforms of disability pensions, social assistance, and study grants. The overall strategy is to meet the financial challenges created by demographic shifts by increasing labor supply and employment. If successful, this strategy will improve public finances both via lower expenses on income transfers and higher tax payments. This strategy has broad political support since it has been more attractive than either tax increases or cutting-back on central welfare arrangements.

In short, when compared to other OECD countries, public finances in Denmark are in relatively good shape. Still, analyses of fiscal sustainability show that the structural balance will display deficits for the coming 35 to 40 years. Although surpluses are expected far in the future, implying that the country’s fiscal sustainability indicator looks reasonably favorable (and among the best within the European Union), it is very risky to base economic policy on a trajectory implying systematic deficits for such an extended period. There is thus an issue with the profile of public finances that needs to be addressed. Moreover it should be noted that an assessment of fiscal sustainability considers whether it is possible to maintain current welfare arrangements, but does not include room for improvements in, for example, the standards and qualities of welfare services (e.g., health). Hence, some pressure on public finances can be expected.
Latvia

Score 9

Both the European Commission and the IMF have deemed Latvia’s budgetary policy to be fiscally sustainable, although challenges will remain in meeting future obligations such as previously legislated tax cuts, or returning the second-pillar pension contributions to pre-crisis rates.

In 2012, the Saeima passed its first medium-term budget framework for 2013 – 2015, which will allow for longer-range planning and stability. In 2013, the Saeima approved a Law on Fiscal Discipline, capping government debt at 60% of GDP and providing for automatic corrections to restore budgetary balance.

Citation:

Mexico

Score 9

Fiscal stability has been a very strong policy priority for the past several administrations. Just as Germany would do anything to avoid a repetition of the hyperinflation of the 1920s, Mexico badly wants to avoid repetition of its debt crisis of 1982 or the “Tequila Crisis” of 1994. Southern Europe’s present difficulties have also been a cautionary tale to the Pena Nieto government of the dangers of fiscal profligacy. Consensus is so strong on this matter, in fact, that all the major parties in Mexico support policies of fiscal stability. In 2008, Mexico accepted a domestic recession as the necessary price to pay for avoiding inflation. In the shorter term, Pena Nieto’s first budget passed Congress easily at the end of 2012.
New Zealand

Score 9

New Zealand’s budgetary policy is fiscally highly sustainable. However, the world financial crisis ended 14 years of budget surplus. The National Party-led government stated very early on that a return to high-debt levels would be imprudent, and made decisions so that gross debt peaked below 40% of GDP in 2010, well below the Organization for Economic Co-operation and Development (OECD) average. Since then, the government has maintained its course of fiscal consolidation, aiming at an operating surplus in 2014 and bringing net debt down to 20% of GDP by 2020. The government announced that it would only be willing to reassess this course if the economy were hit by a severe negative shock that might imply that sticking to the current fiscal strategy would harm the economy by forcing a sharp reduction in demand. The proposed sale of shares in targeted state-owned energy companies will doubtless help offset the government’s spending commitments.

Citation:

Turkey

Score 9

Total government expenditures in 2010 totaled 26.8% of GDP then fell in 2011 to 24.2% of GDP, rising in 2012 to 25.1%. Interest payments on public debt fell in 2010 from 4.4% of GDP to in 2011 3.3% of GDP, rising in 2012 to 3.4%. During the period, there were no major changes in the composition of government expenditure, such as current transfers and personnel costs. While current transfers decreased in 2010 from 9.3% of GDP to in 2011 8.5% of GDP and then in 2012 increased to 9% of GDP, personnel costs decreased in 2010 from 5.7% of GDP to in 2011 5.6% of GDP and then in 2012 increased to 6%.

As of the end of 2010, gross public debt totaled 39.9% of GDP. After falling in 2011 to 39.3%, the gross debt-to-GDP ratio increased in 2012 to 42.8%. The net public debt-to-GDP ratio decreased in 2010 from 28.9% to 22.3% in 2011 and further to 17% in 2012. The government has been financing budget deficits by borrowing at 8.5% in 2010, 8.7% in 2011 and 8.8% in 2012. Noting that the inflation rate measured by the CPI index totaled 8.6% in 2010, 6.5% in 2011 and 8.9% in 2012, the real interest rate was -0.1% in 2010, 2.2% in 2011 and -0.1% in 2012. In sum, Turkey’s fiscal policy has been sustainable, as underlined by the State Planning Organization (2012).

Citation:
Canada

Canada’s government is in a strong fiscal position. Private-sector employment is today above its pre-recession peak, indicating that the economy has recovered from the 2008 recession. Canada’s budget deficit as a proportion of GDP is low by international standards, as is its public debt/GDP ratio. The federal budget released in March 2013 projects higher revenues as the economy expands, with the deficit projected to be eliminated by 2015 – 2016. The fiscal situation is somewhat weaker in certain provinces, such as Ontario, but budgetary balances are moving in the right direction.

One challenge to long-run fiscal sustainability is the rising health-care costs associated with the aging of the population. However, this issue has received much attention and measures are being taken by provincial governments, which have responsibility for health care, to reduce the rate of increase of health-care spending. For example, the Ontario government commissioned a major report (the Drummond report) to chart a path to sustainability for its public finances, and the report devoted particular attention to the health sector.

Citation:
Commission on the Reform of Ontario’s Public Services (Drummond Report) Public Services for Ontarians: A Path to Sustainability and Excellence, February 2012.

Germany

Given the enormous fiscal efforts resulting from the recent euro-area debt crisis, as well as the liabilities assumed in order to overcome the effects of the financial and economic crisis, Germany’s budgetary situation is surprisingly good. Although Germany’s government-debt-to-GDP ratio amounted to 81.9% at the time of writing, just 0.5 percentage points lower than its all-time high in 2010, the country had not been downgraded by rating agencies and indeed retained the highest-possible credit ratings throughout the crisis. Budget deficits and gross public debt levels were pushed up by crisis-related revenue shortfalls, anti-crisis spending packages, and bank bail-out costs. To address challenges posed by the financial crisis and other structural problems, a constitutional debt limit has been introduced (Schuldenbremse) that restricts the federal government’s cyclically adjusted budget deficit to a maximum of 0.35% of GDP, and requires the federal states to maintain balanced cyclically adjusted budgets. In the wake of the economy’s quick recovery, and as a consequence of effective spending
restraints, the budget deficit fell drastically during the period under review, ultimately coming unexpectedly close to the debt-brake target. In 2012, new net borrowing amounted to just 0.32% of GDP, and was thus already in line with the constitutional debt limit. In sum, regarding the combined revenues and expenditures of the federal, state and communal levels, as well as the public social-insurance carriers, Germany even achieved a slight budget surplus of 0.2% (cf. Statistisches Bundesamt). Furthermore, the course of fiscal consolidation has drawn strong support among voters; proposals to cut taxes are widely regarded with skepticism.

In its recent sustainability report, which takes the impact of the aging population on budgetary sustainability into account, the European Commission acknowledged that “Germany does not appear to face short-term, medium-term or long-term sustainability challenges” (European Commission 2012: 11). Nevertheless, this positive favorable development is not without risks. Germany currently benefits from historically low government-bond interest rates. And given its high debt level, a downturn in conjunction with the financial guarantees made to the European Financial Stability Facility (EFSF) and the ESM could jeopardize Germany’s future financial soundness.

Lithuania

Score 8

During the financial crisis, Lithuania’s fiscal situation deteriorated rapidly; the fiscal deficit grew to 3.3% of GDP in 2008, and further to 9.4% in 2009. As a result of fiscal consolidation, the deficit dropped to 7.2% in 2010 and again to 5.5% in 2011. It was expected to continue falling to 3.2% in 2012. The European Commission has assessed Lithuania as being on track to reducing its general government deficit to close to 3% of GDP, thus qualifying for eurozone inclusion under the criteria of the Maastricht treaty. Government debt also expanded during the crisis, reaching 38.5% of GDP in 2011 (from the precrisis low of 16% in 2008); this is expected to stabilize at around 40% of GDP in 2012 – 2013.

However, Lithuania faces a number of challenges in terms of keeping its public finances sustainable. Factors such as projected expenditure related to an aging population, as well as the vulnerability of its small and open economy to external shocks, pose significant risks to the consolidation path projected by the Lithuanian government in its convergence program. The goal of introducing the euro in 2015 might preserve the current government’s determination to maintain the deficit at a level below 3% of GDP, while the fiscal-discipline law should provide incentive to continue reducing the deficit even as the economy keeps growing.
Luxembourg

Score 8

From 2008 to 2012, Luxembourg’s public debt rose from 13.5% to 20.9% of GDP or €9 billion. The government’s guarantee of two Luxembourg banks (Banque Générale de Luxembourg and Banque Internationale à Luxembourg) for more than €4.5 billion particularly affected public finances. The public deficit in 2013 edged close to the 3% threshold of GDP. But when compared to other EU members, Luxembourg’s finances are still stable and it remains the richest country in the OECD. The small country’s main concern is the challenge of predicting how the economic crisis will play out in other EU countries.

The growth potential of Luxembourg’s economy is based on short-term regulatory niches. The state budget, as well as the budget for the country’s generous welfare state, is based on a pattern of continuous economic growth from consistent revenues from the financial sector and in recent years, from e-commerce. This of course cannot any longer be guaranteed on a long-term basis, as the future of these regulatory niches is uncertain. As part of the progress toward harmonization, the special taxation regulations over e-commerce essentially end in 2015, while new levels of transparency over capital income will also be required from 2015 onward (as part of the Fair and Accurate Credit Transaction Act (FATCA) as well as a new EU directive) – both of which will make Luxembourg less economically attractive. The recent announcement by the minister of finance that Luxembourg is ready to accept an automatic information exchange is also likely to dampen the country’s financial sector.

Individual tax rates and low indirect labor costs (lowest within the EU-15) keep Luxembourg attractive for foreign industrial companies and international companies. Most enterprises pay few taxes, with only 20% of companies paying business tax. But changes are planned following the review period. Rules over stock options (given as employee bonuses) will change and a minimum tax on holding companies (sociétés de participations financières) is scheduled to be introduced. For the first time, all trading companies now pay taxes. In addition, the government plans to introduce a minimum tax for automobiles and to abolish the automatic inflation adjustment of the tax table. The problem of tax arrears needs to be solved through a modern, computerized tax administration.
South Korea

Korea's budget policies seem to remain sound – at least at national level. While fiscal debt has increased under the Lee administration, Korea is one of the OECD countries with the lowest levels of public debt and public expenditure. The official debt to GDP ratio in Korea is only 34% in 2011. Some researchers, however, argue that huge amounts of government debts are hidden in state-owned companies. According to the estimations of the Naumann Foundation in Seoul, the total amount of government debt could be about three times the official figure.

The government has been remarkably pragmatic in abandoning what have traditionally been very conservative fiscal policies, implementing the OECD's largest fiscal stimulus in an attempt to sustain economic growth. The country's budgetary soundness was favorably assessed in the OECD's March report, Preparing Fiscal Consolidation. 2009 was the only year since the beginning of the global economic crisis in 2008 when Korea recorded a budget deficit, and it is projected to run surpluses in 2012 and 2013 as well. On the other hand, low overall government expenditure leaves room for doubt as to whether, amid a maturing economy and an aging society, the Korean government is prepared to take more responsibility, particularly with respect to increasing spending for social security and education. The recent shift of government expenditure to construction projects might also create short-term growth at the expense of a long-term debt burden. Critiques of big construction projects like the Four Rivers Project as a waste of taxpayer money have increased over the last two years.

At local level, budget problems have become worse mostly due to prestige construction projects without many economic benefits. In 2010, Seongnam City was the first Korean government that had to declare a moratorium on its debt payments. In early 2012, Incheon, Korea's third largest city, ran into financial difficulties.
Australia

Fiscal sustainability has become a significant issue in Australia over the review period. The high commodity prices of the early to mid-2000s generated large increases in government revenue, to a significant extent deriving from corporate tax revenue. Much of the additional revenue was spent on income tax cuts and increases in family benefits and several other entitlement programs. Corporate tax revenue has not recovered from the 2008 – 2009 economic downturn, and towards the end of 2012 the federal government had to abandon its planned return to a fiscal surplus in the 2012 – 2013 financial year, after four successive years of deficits. Before the global financial crisis, Australia’s budgetary policy showed that fiscal prudence and significant economic growth do not exclude each other. The major drawback of the sound fiscal policy has been a lack of investment in infrastructure. Net federal government debt has risen from 1.5% of GDP to 24.1% of GDP in 2011–2012. While the fiscal position is still relatively healthy, several leading analysts have expressed the view that Australia now has a “structural deficit,” meaning that, averaged over the business cycle, existing revenue streams will not be adequate to meet ongoing expenditure needs given the current tax rates and expenditure levels. The reasoning is that commodity prices will not return to pre-2008 levels, and expenditure demands are projected to increase over coming years, in part because of population aging. The fiscal forecast has not been helped by the government’s announcement of several new, largely unfunded, programs in education and health.

Citation:
Australian Government Treasury historical budget and net worth data: http://www.budget.gov.au/2012-13/content/overview/html/overview_44.htm

Austria

Score 7

There is consensus among most of the members of Austria’s decision-making elite that the country’s budget deficit must be reduced. However, as the Austrian economy is still quite robust, at least in the European context, and as the social-policy consensus among the two governing parties is
broad, there is comparatively little incentive to limit expenses. The political parties are reluctant to confront their specific clienteles (farmers and public servants for the Austrian People’s Party (ÖVP), and unionized workers and retirees for the Social Democratic Party of Austria (SPÖ)) with policies that might undermine their particular interests. The budget consensus – the long-term focus on eliminating the deficit – is hardly ambitious; under current plans, this point will not be reached before the end of the decade, and even this depends on assumptions outside the control of Austrian policymakers.

In the past, Austrian budgetary policies have followed a biased Keynesian approach: In times of low growth, the government has engaged in extra spending regarded as investment in the improvement of growth. In times of high growth, however, available funds have not been used effectively to prepare the government for worse times.

Austria recently enacted a new Federal Medium-Term Expenditure Framework Act (BFRG), which enables the government to plan the budget over the medium term. The BFRG prescribes binding ceilings on expenditures for four years in advance, on the basis of five categories that correspond to the main functions of the federal government. This multi-year approach should help improve the sustainability of the federal budget.

Belgium

Score 7

The country’s financial sustainability was better restored in the 18-month period of apparent stasis after the 2010 legislative elections than during previous periods of apparent motion. Of course much remains to be done, if only because reforms hurried through in back-room sessions during the crisis were necessarily imperfect. Tax policy still needs a grand overhaul, as well as pension policy, due to an aging population and a diminishing ratio between active and non-active citizens. The goods and labor markets still require structural improvements. The financial sector suffered much during economic crisis, and may be hiding non-performing debt. Overall, however, government action is headed in the right direction.

Iceland

Score 7

The 2008 economic collapse dramatically increased the country’s foreign debt. General government gross debt rose from 29% of GDP at the end of 2007 to 93% in 2010, and is forecast to decrease to 90% in 2013 and 82% in 2017. General government net public debt – that is, the government’s foreign debt minus its foreign assets – stood at 11% of GDP at the end of 2007, 56% in 2009 and 66% in 2011, but was projected to drop to 64% in 2013.
In documents supporting the stand-by agreement with Iceland, which was completed during the period under review, the IMF expressed the view that Iceland’s public debt was sustainable if the country adhered to the fund’s fiscal program. Other observers have been less sanguine, given Iceland’s less-than-stellar history of economic stability.

The country’s financial prospects also improved somewhat when it became clear that the so-called Icesave debt to Great Britain and the Netherlands, which was associated with the collapse of the Landsbanki bank, could be served through funds obtained from the bankrupt Landsbanki itself due to better-than-expected asset recovery. In January 2013, the EFTA Court of the European Free Trade Association states cleared Iceland of all charges in connection with having refused to guarantee deposits made by United Kingdom and Netherlands account holders, a sum worth €4 billion plus accrued interest. However, this claim will still exist as a so-called first priority claim on the old Landsbanki estate, and is now expected to be met in full.

One factor complicating assessments of Iceland’s fiscal sustainability is the tenuous situation with respect to foreign exchange values and availability. As of the time of writing, foreign entities had a considerable quantity of funds locked up behind capital controls in Iceland. Investors generally wanted to move these funds out of the country, but were prevented in part by the capital controls. Once these are lifted, or the funds are otherwise able to flow outward, a shortage of foreign exchange would likely ensue, leading to a significant drop in the value of the Icelandic króna on international currency markets.

Citation:
IMF, October 2012 World Economic Outlook.

Israel

Score 7

After the deep economic crises of the mid-1980s, key steps were taken to reduce Israel’s budgetary deficit and to build a set of objectives and guidelines enabling sustainable budgetary planning.

As part of this effort, strict budgetary-discipline laws were enacted. The Budget Foundations Law, for example, set strict spending procedure regulations and implemented deficit-reporting requirements. Another law prohibited the central bank from providing loans to the government, ensuring that future deficits would be financed by borrowing from the public and abroad rather than through direct monetary injections. The consequence of these laws was to centralize fiscal power, giving the Ministry of Finance’s Budget Department the power to impose a policy of budgetary discipline.
Two crucial additional laws, the Arrangements Law (Hok Ha-Hesderim), and the Budget Deficit Reduction Law, helped redefine the financial and economic structure of Israel. The latter law restricted the government’s flexibility by setting out a future path of deficit reduction. For its part, the Arrangements Law is actually an omnibus law passed with each budget, consisting of a number of reforms and amendments designed to enable the spending document to achieve the state’s financial goals. In the last few years, the budget has been shifted to a biennial basis, which many regard as having had a positive influence on the ability to reach these goals.

This history of successful reform continues to contribute to the stabilization of the Israeli economy. Along with a skillful monetary policy, these measures helped the country weather the last economic crisis relatively successfully.

Citation:
Ben Basat and Mumi Dahan, “Power balance in the budgetary process,”IDI website 2006 (Hebrew) http://www.idi.org.il/ID%7A1%7A4%7A8%79%7D%9D-%79%7E%79%7E%7A%7A%7A%7D%9D-%7A%7D%9D-
%7A%79%7E%7A%7A%7A%7D%9D-%79%7E%7A%7A%7A-

Fisher, Stanley, “Main aspects of the new law for the Bank of Israel,” speech at the conference in memory of the late Amnon Ben-Natan, Tel Aviv, 3 January 2008 http://www.bis.org/review/080110b.pdf


Netherlands

Score 7

Budgetary policy was sound prior to 2008. The economic crisis, however, has put severe pressures on the government budget. In 2012 the government could not cover its expenditures from current incomes. The government came €0.10 short on every €1 of expenditure. The national balance switched from a surplus in 2008 to a deficit of 4.1% of GDP in 2012 – 0.3% higher than expected. Total government debt increased to 71.2% of GDP. High debt is partially masked by the low interest rate on state obligations. Both national balance and debt figures are higher than the European Monetary Union (EMU) norms of 3% and 60% of GDP. The deficit is caused by expenditures that have increased since 2009. Income decreased due to the credit crisis, but returned to 2008 levels in 2012. The
rise in expenditures is due to increasing costs for social benefits and care – comprising about half of all government expenses. The rise is arguably a result of the demographic trend of aging. The current policy to increase the age for retirement is therefore justified by the goal of improving budgetary sustainability. In spite of strong austerity measures for the near future announced in the Rutte II agreement, it looks like the Dutch government is speculating on gaining additional time to achieve the EMU and EU 3% deficit criterion, banking on its reputation for solid budgetary and socioeconomic policymaking with a view to structural budget sustainability.

Citation:
Overheidsfinancie, Begrotingsbeleid (www.rijksoverheid.nl/onderwerpen/overheidsfinancien/begroting)
D. Samsom (2012), Keuzes die de samenleving versterken, in Socialisme & Democratie, jrg. 69, nr. 12, pp. 8-12

Slovakia

Score 7
Slovakia’s public debt has risen, but has been relatively low from a comparative perspective. The Radičová government was strongly committed to fiscal consolidation and succeeded in reducing the fiscal deficit by more than 3% of GDP from 2009 to 2012, largely by cuts in spending. It also initiated the passage of a Constitutional Act on Fiscal Responsibility in late 2011 that has required the government to pass consolidation measures when the public debt (as measured by Eurostat) exceeds 53% of GDP and has led to the creation of an independent Council for Budgetary Responsibility to monitor fiscal developments. The Fico government’s commitment to fiscal consolidation has been less clear-cut. On the one hand, Fico backed the Constitutional Act on Fiscal Responsibility when in opposition, and was keen to prevent an increase in deficits when back in power. On the other, he has openly criticized the austerity policy in the eurozone and has ignored concerns by the Council for Budgetary Responsibility about medium-term fiscal development.

Croatia

Score 6
In line with the obligations enshrined in the 2010 Fiscal Responsibility Act, the Milanović government succeeded in reducing the fiscal deficit and in meeting its fiscal target in 2012. However, fiscal consolidation has not been sustainable. According to projections by the European Commission in 2013, the budget deficit as a percentage of GDP is to increase over the next few years. The Commission also expects the 60% of GDP debt-ratio threshold to be crossed in 2014 due to both higher deficits and lower GDP growth than projected in the government’s programs. Part of the increase in the debt
ratio, which stood at 46.7% of GDP in 2011, is a result of the depreciation of the Croatian kuna since a large share of Croatian public debt is denominated in euro and US dollars.

Citation:

Czech Republic

Score 6

Elections in May 2010 gave a strong mandate to a right-wing government that then pursued a neo-liberal approach reflected in the declining share of state spending. The government has declared itself the government of budgetary responsibility and one of its main tasks was the reform of public finances with the aim of stopping rising public debt and setting the parameters of budget policy to balance state budgets by 2016. In line with this task, the 2011 budget envisaged reductions in public sector salaries and cuts in investment and social benefits. The measures did not bring the expected results and the government adopted another austerity package that consisted of savings to reduce the budget deficit starting in 2013. This succeeded in reducing the budget deficit in 2012 to 2.6% of GDP, but at the expense of a decline in GDP of 1.2% during that year. State debt reached 43.4% of GDP at the end of 2012. Government budgetary policy has thus been successful in holding debt at a very manageable level with no imminent danger of insolvency. However, it has led to a decline rather than economic growth and this trend continued into 2013. That makes it more difficult to achieve the ambitious target of a fully balanced budget without a further downward spiral of spending cuts leading to further GDP decline.

Poland

Score 6

Fiscal adjustment has featured prominently in the initial policy declarations of the second Tusk government. The government has indeed succeeded in reducing the fiscal deficit from 7.9% of GDP in 2010 to 5% of GDP in 2011 and about 4% of GDP in 2012 and 2013. However, deficits in 2012 and 2013 have been higher than expected and have brought the public debt close to national legal debt thresholds. Given slowing economic growth, however, the Tusk government has refrained from further fiscal tightening. The pushing back of the target date for reaching the government’s medium-term objective of a structural deficit of 1% of GDP from 2015 to 2016 and the failure to adopt medium-term fiscal rules, which have been under discussion for some time, have raised strong concerns about the sustainability of fiscal policy.
United Kingdom

Score 6

The United Kingdom is a highly centralized state which puts the government in a powerful position to exert control over budgetary policy. Most spending is directly or indirectly controlled from Whitehall, and there are few other influences compared to, for example, federal countries. This also means, however, that the central government has to shoulder the blame if things go wrong.

During most of the New Labour government, the “golden rule” was the guiding of UK fiscal policy, limiting deficit spending to investment over the business cycle. However, public spending was rising as a proportion of GDP during the 2000s, and can now be judged to have been too pro-cyclical. In 2009, adherence to fiscal rules was abandoned to cope with the consequences of the crisis. In 2010, the new coalition government implemented a strict fiscal austerity program to focus on consolidation instead of boosting the economy. It also created the Office for Budget Responsibility (OBR) to assess fiscal policy independently.

Although the budget deficit is declining, fiscal consolidation is happening more slowly than the government planned and, in the meantime, public debt has soared. However, markets have been kind to the United Kingdom, with low financing costs (helped by very loose monetary policy) and this can, within reason, be interpreted to mean that the public finances are sustainable.

France

Score 5

France’s budgetary situation at the time of writing is unsustainable. The failure in recent decades to restructure public spending has had a negative impact on budgetary policy. The political elite, with the support of the voters, has effectively shifted present costs to future generations. As a result, most fiscal and other economic indicators, including public deficit as a percentage of GDP, public debt as a percentage of GDP, social security and pension spending are recording discouraging figures: the public deficit, general public debt and social security and pension systems. Although the financial crisis has only added to these problems, the deficits are essentially of a structural nature. Both Presidents Sarkozy and Hollande tended to avoid all forms of “austerity,” promising to meet problems of debt with more economic growth or, in the absence of growth, raising taxes rather than doing with less public expenditure. Faced with a further deterioration of the country’s economic situation and with EU obligations to restore the balance of public
finance, President Hollande during the review period made a turn in fiscal policy. While sticking to the objective of reducing deficits and debt, he announced that public spending should be curbed to reach that goal. France has succeeded in reducing its structural deficit, down 1.2 percentage points in 2012 and another 1.8 percentage points in 2013. For 2014, a further reduction by 1 percentage point is expected. A cut in public expenditure of €1.5 billion is scheduled for the 2014 national budget. France has been given two more years to reduce its annual public deficit to less than 3% of GDP (the euro zone target, consistent with the obligations of the Stability and Growth Pact). It is still to be seen if President Hollande will succeed in cutting public expenditures, given that this policy has met with strong opposition in his electorate. The reforms to reduce structural deficits will need time before showing any effect, and a return to fiscal sustainability will be strenuous.

Italy

Score 5

In the second half of 2011, during the last months of the Berlusconi government, doubts about the fiscal sustainability of Italy had become very serious. The Greek crisis remained unsolved, Italian 10-year bonds rose dramatically compared to German ones (in November 2011 they reached a level of more than 500 basis points) and there was strong internal dissent in the Council of Ministers between the Treasury, which tried to ensure fiscal moderation and the other ministers. Many national and international observers had serious doubts about Italy’s chances of avoiding a budgetary crisis without external help.

The prompt decisions taken by the Monti government in fiscal and budgetary matters, coupled with a regained prestige of Italian political leadership at the European level, and the new policies of the ECB have changed the situation very significantly. The level of public debt to GDP has continued to increase in part because of the new burden of contributing to the European Financial Stability Facility and European Stability Mechanism – which cost the Italian state approximately €40 billion between 2010 and 2012 – and in part as a statistical effect of GDP shrinking due to recession. It reached 127% of GDP at the end of 2012, but the government has been able to bring the level of deficit under control to the point that the primary balance of Italy in 2012 (2.5% of GDP) was among the most positive in Europe. International stability of the public finances is also guaranteed by a highly experienced debt management department within the Ministry of Economics and Finance: interest rates paid on long-term treasury bonds have significantly decreased. But it is also a fact that all levels of the public administration have a debt of some estimated €90 billion with private business in Italy. So the state, regions and municipalities clearly do not sustain economic growth but in fact do the contrary.
The government has thus begun a more virtuous path that should enable it to start reducing the levels of debt and thus reverse the highly negative practice of shifting the burden of expenditures onto future generations. In the short term, however, these policies have negatively affected economic growth.

Citation:

Spain

Score 5

Even if the Spanish economic crisis has many dimensions (high unemployment, banking sector problems, private debt, low productivity and added value, rigid labor market, etc.) budgetary policy has perhaps been the top priority from 2011 to 2013. The spending cuts implemented by the current government and its predecessor in an attempt to reduce the deficit and public debt have been the main economic strategy – in fact, the only one considering the small margin for implementing any other fiscal policy, the absence of autonomous monetary policy and the risks of insolvency that may have forced Spain into a bailout scheme with its long-term borrowing costs exceeding 7% in July 2012.

The most important initiatives in this domain have been the constitutional reform agreed in September 2011 between the then-socialist government and the Popular Party (Partido Popular, PP) opposition to change Article 135 which establishes the obligation of a balanced budget and requires that the state give public debt payments priority over any other expenditure, and the Organic Law 2/2012 on Budgetary Stability and Financial Sustainability of Public Administrations. It is obvious that, with the highest public deficit of the European Union during 2012 (10.6% GDP including the banking bailout) and public debt near 100% GDP, the budgetary policy has not realized the goal of fiscal sustainability.

However, these imbalances must be considered in the context of the severe economic crisis. In fact, the spending cuts have been achieved with remarkable effectiveness by central and regional governments (effective from an austerity-ridden fiscal policy perspective) and the fact is that public deficit is now caused by a fall in revenues rather than by uncontrolled spending. By mid-2013 – also thanks to more flexibility in the EU calendars to curb deficit – the government has regained some credibility with respect to its capability to produce accurate estimates and, if economic growth consolidates, the long-term sustainability of Spanish public finances will have improved with respect to 2010.
Cyprus

Cyprus’ balance of payments in 2008 was positive, with a significant amount of reserves. However, the financial crisis and structural economic imbalances have affected budgetary stability. Previously, at a time when state income depended strongly on unpredictable factors, expenditure was steadily increased. Tax revenue subsequently declined as a result of the economic slowdown, the shrinking tourism industry, fluctuating oil prices and other developments. The volume of unpaid taxes exceeded €1 billion in 2012. Meanwhile, expenditure increased due to inflated public-service salaries and rising social outlays associated with higher unemployment rates, severance payments and other costs.

As a result, the government deficit increased from 4.9% in 2010 to 6.1% in 2011, with a preliminary 2012 budget deficit estimated at 6.3% GDP. Responding to the European Council’s recommendation to correct the deficit, the government ultimately reduced it to 4.9% in 2012. The country’s fiscal crisis deepened in the 2012 – 2013 period due to the Greek financial crisis and the write-down on Greek bonds. Domestic banks with significant exposure to Greece lost a large amount of capital, and subsequently sought government recapitalization and assistance from the European central banks’ Emergency Liquidity Assistance (ELA) program. Cyprus’ own government provided bank support totaling more than 10% of GDP.

The government sought to cover its current expenses by taking out short-term external loans that proved impossible to pay back, while failing to take drastic measures to reverse the trend of rising salaries and expenditure. Thus, the debt ratio was projected to rise to 85% of GDP in 2013, and to 102.7% in 2014. This has further weakened the long-term sustainability of public finances. Net debt-interest payments already amounted to 2.40% of GDP in 2011, positioning Cyprus at 27th place among the 41 countries surveyed by the SGI, following the United States. In addition, age-related expenditure growth must be contained, with pension reform critical, if public finances are to be returned to a sustainable path in the long term.

Greece

After the economic crisis erupted in Greece in 2010, servicing the public debt became the first priority of the Greek government, but the ensuing depression depressed government revenue. Incomes decreased and the total of tax revenue was also lowered. For instance, as IMF data show at least nominally, in 2011 each Greek child was burdened with a share of the public debt which was close to $300,000.
Fiscal consolidation was attained to a large extent, in the sense that the primary deficit was sharply reduced in 2011 – 2013. However, owing to the contraction of the economy in the same time period, the public debt increased further. It is expected to stabilize at 175% of GDP in 2013 and stay at that level in 2014. This is an unsustainable level and there is speculation that Greece’s creditors may consider agreeing to a reduction of the debt. This prospect was, however, rejected in early 2013, as most of Greece’s public debt is held by foreign governments. Forgiving part of the debt would thus mean that taxpayers of other countries would be negatively affected.

On the other hand, without further funds coming from foreign governments, Greece would have grave difficulties overcoming the crisis in the near future. Today the Troika closely monitors budgetary policy and has helped make it more sustainable than in the past, in particular because these institutions forced Greece to overcome its formerly anachronistic budget management process, with some 14,000 separate budget items – all poorly coordinated. The government claims that, owing to the prudent budgetary policy of the period 2011 – 2013, small, but visible, positive economic growth will be in sight by the beginning of 2014.

In brief, Greece’s Herculean efforts to implement harsh austerity measures in order to improve on its budgetary policy will not succeed unless accompanied by corresponding measures, agreed internationally, to manage the country’s public debt in a sustainable manner.

Ireland

Significant progress towards correcting the budget imbalances has been made over the past two years, but there is still a long way to go before the target of reducing the deficit to 3% is reached. This target is considered sustainable given current interest rates and the projected rate of growth of nominal GDP. Further progress depends on maintaining political support for implementing two more austerity budgets. The economy and financial system are still fragile and the program could be blown off course by the protracted recession in Europe, and the ongoing instability of the European monetary and banking system. The fiscal policies being pursued under the Troika are clearly pro-cyclical, reducing domestic demand at a time of exceptionally high unemployment. It remains to be seen if the countervailing increase in confidence due to the slowly improving fiscal balance will counteract these negative forces and allow the economy to grow. It is doubtful if the fiscal targets set for 2015 can be achieved if unemployment remains at its peak and employment fails to expand.
Malta

As part of its 2013 budget, and during an election year, the government made promises to cut taxes and increase welfare support. Although the budget failed to pass in parliament, the opposition party declared that if elected, it would adopt the budget with only minor amendments. Many of these measures may challenge the government-elect’s claim that the budget could be adopted without significantly impacting the budget deficit. The financial crisis also pushed the government to inject more money into the economy as a means to safeguard employment and investments; however, the government also embarked on a series of highly contested projects, such as the building of a new parliament building, the transformation of a war-damaged opera house into an open air theatre, and the reconstruction of the Valetta breakwater bridge, which was destroyed during WWII (for which no adequate funding was available).

The potential waste of public funds has become a contested point in Malta. The result has been an unprecedented rise in the government debt-to-GDP ratio and its servicing commitment. Since the March 2013 elections, it has also transpired that the deficit is actually higher than stated in the budget figures; that many measures in the 2013 budget are expansionary; and that projected tax revenues are probably optimistic. It is also likely that the government at the time of writing will need to trim its budget and project aspirations if it is not to incur sanctions from Brussels over both its deficit and the level of government debt. Malta has signed up to the EU Fiscal Stability Pact while the European Union, in light of new economic information, is considering whether to open procedures against Malta. The 2012 report by the European Commission has urged Maltese authorities to adopt additional measures to ensure that the deficit falls below 3% of GDP in 2013; to curb current spending while preserving capital spending; to tighten controls on the growth of health spending; to increase the use of means-testing for government benefits; and to contain the government’s wages bill through prudent collective wage agreements and a compression of public sector employment through attrition.

Citation:
http://www.timesofmalta.com/articles/view/20111028/opinion/For-a-sustainable-Budget.391117
Calleja, C. Shame of Health Waste, Times of Malta 12/06/13
Romania

Score 4

In January 2013 the Ponta government approved an annual budget targeting deficit to 2.1% of GDP through revenue boosting measures, especially through higher taxes on energy suppliers. The target, which would allow the government to exit the European Union’s excessive deficit procedures, are based on a projected GDP growth of 1.6%. However, the government also affirmed an intention to increase public salaries and pensions by allocating €10.2 and €11.1 billion respectively and raising the minimum wage from the current RON 700 to RON 800 and it is considering a 5% reduction in the VAT rate by January 2014. While these measures are politically attractive in the context of the upcoming presidential elections, they risk a renewed failure to meet deficit targets and by April 2013 the budget deficit already amounted to 1.2% of the annual GDP. Romania’s fiscal sustainability is undermined by the fact that in almost 75% of localities wage expenses significantly exceed revenues, thus creating a serious dependence on discretionary allocations from a variety of funds, such as the Disaster Relief Emergency Fund and funds for roads (county and rural), schools, rural water systems and bridges. While the Ponta government has promised to end the practice, the opposition has complained about discretionary payments to Social Liberal Union (USL) mayors.

Slovenia

Score 4

The Pahor government, elected in late 2008, reacted reluctantly to the economic crisis. It confined itself to adopting relatively small fiscal stimulus packages and did not adopt any measures to limit public expenditure growth in the medium-term. Due to the steep decline in output, the fiscal stance deteriorated drastically after 2009. Medium-term fiscal problems are further aggravated by the rising debt accumulated by the health care sector, by public companies and especially by state-owned banks. While the Pahor government refrained from launching major fiscal adjustments, the Janša government succeeded in lowering the fiscal deficit by freezing employment in the public sector and cutting public spending. On 25 May 2013, the Slovenian Parliament, in line with the European Union’s Fiscal Compact, enshrined a “debt brake” in the constitution.
Hungary

Score 3

The predominant goal of budgetary policy in Hungary has been to keep the fiscal deficit below 3% of GDP and to exit from the EU’s excessive deficit procedure originally initiated in 2004. The Economic and Financial Affairs Council of the European Union eventually closed the deficit procedure in June 2013. As evidenced by the recurring reliance on short-term austerity packages, however, fiscal adjustment has been accomplished through ad hoc measures rather than through structural reforms. Moreover, about two-thirds of the adjustment has been achieved by government revenue increases. The short-term orientation of fiscal policy was favored by the reform of the Fiscal Council in 2010, which limited its remit, its resources and its independence. Even the current council, however, has criticized the government’s haphazard fiscal policy and its lack of sustainability. Hungary is also still far away from meeting the debt ceiling of 50% of GDP enshrined in the new constitution. It fits to the lack of a long-term fiscal strategy that Hungary has ratified the European Fiscal Compact, but has insisted that its consolidation requirements apply only after its membership in the euro zone.

Citation:

Portugal

Score 3

In theory, taxes should be sufficient. However, three of the four posited goals have not been achieved. This situation is in part due to high costs of public administration with an elevated number of civil servants (578,384 out of 3,827,000 total employed persons in the last quarter of 2009) and the fact that public companies lose money. The taxes are not sufficient to cover the costs of public expenditure, especially as the economic recession had a negative impact on tax receipts while increasing public welfare expenditure.

The initial Memorandum of Understanding (MoU) stipulated the goal of “Reduce[ing] the government deficit to below €10,068 million (equivalent to 5.9% of GDP based on current projections) in 2011, €7,645 million (4.5% of GDP) in 2012 and €5,224 million (3.0% of GDP) in 2013.” However, these targets have been altered twice already. Thus the 2012 budget deficit was revised to 5% in September 2012. In March 2013, the targets were further changed to 5.5% budget deficit in 2013, 4% in 2014 and 2.5% in 2015. These revisions reflect the inability to reach the original targets, with the official budget deficit reaching 6.4% in 2012.
United States

Score 3

The condition of budget policy in the United States is quite complex and raises different concerns depending on the time perspective of the assessment. In the depths of the 2008–2009 recession, the budget deficit, enlarged by the fiscal stimulus, reached $1.4 trillion, or 9.9% of GDP. While the deficit shrunk to 7% of GDP in 2012, recovery has been too slow to stimulate economic growth. At the same time, long-term deficits are by all accounts seriously beyond acceptable levels. As the Congressional Budget Office testified in 2013, “Under current law, federal debt appears to be on an unsustainable path.” The primary cause of this condition, in addition to the severe limits on revenues, is the growth of the elderly population and the generous terms of Medicare and Social Security – health care for the aged and retirement benefits. Faced with such challenges, lawmakers of all political persuasions are calling for reform.

Yet since the mid-term election in 2010, Republicans and Democrats have failed to find a budget policy compromise. The president and congressional Democrats have defended entitlement programs against even modest reductions in spending, almost as rigidly as Republicans have opposed increased taxes. In short, U.S. budget policy provides too little current stimulus to promote robust growth; seriously fails to balance revenues and spending over a 10-20 year period; and yet underfunds most government services– from infrastructure and border security to environmental regulation and R&D.

Japan

Score 2

Public indebtedness in Japan amounts to 230% of GDP, or 140% on a net basis, the highest such level among developed economies. The budget deficit remains high, with government projects of around 6.9% for the 2013 – 2014 fiscal year by the government. The OECD has urged the government to address the deficit problem more seriously. The government has expressed an intention to reduce the primary balance to 3.2% in fiscal year 2015 – 2016, but as of the time of writing, had not indicated how it intended to reach that goal.

From a short-term perspective, nominal interest rates remain low (rarely higher than 1.5%). A major factor producing these rates is the fact that more than 90% of public debt is held by Japanese, mainly institutional investors. The government and such institutional investors obviously have no interest in lower bond prices, and this oligopoly of players can sustain the current price level of Japanese government bonds. However, should national savings fall
short of domestic needs, a foreseeable condition as a result of the aging of Japanese society, new government deficits may not be able to be absorbed domestically. As a result, government bond prices may fall and interest rates may rise at a fast pace, which would create extremely serious problems for the Japanese government budget and the country’s financial sector.

The country’s aggressive monetary-easing policy, implemented beginning in early 2013, may have partially been intended to monetize the public debt, drawing on inflation to lower its real value. However, any such inflationary shock could easily become uncontrollable. The government’s aim of regaining fiscal sustainability in the medium term thus depends on a highly optimistic scenario.

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