Budgets Report

Budgetary Policy

Sustainable Governance Indicators 2019

SGI Sustainable Governance Indicators

Bertelsmann Stiftung

Indicator

Budgetary Policy

Question

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.

Switzerland

Score 10

Budgetary policy in Switzerland is fiscally sustainable. Gross public debt (general government) rose from a low 29% of GDP in 1990 to a peak of 52% in 1998, but receded to 29% by 2016. Structurally adjusted budgets were balanced even during the crisis of 2008 and 2009. It must be noted that the Swiss federal state is very slim in international comparison: only about a third of state expenditures are spent by the federal government. Since the turn of the century, the federal budget was always in the black or at least balanced, with the government spending less than it received – with the exception between 2002 and 2004. In all likelihood, this positive balance will be maintained over the coming years. For 2018, an excess income of CHF 2.5 billion is expected, corresponding to about 3.6% of federal expenditures.

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 structures have been developed to avoid the dynamics of expanding budgets. For example, on the federal level, there is the constitutional debt brake (Article 126): “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, 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.

Notwithstanding a very favorable fiscal position, the Federal Council pursues moderate austerity programs. 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.

Citation:
Sources: Eidgenössische Finanzverwaltung and Bundesamt für Statistik (2018): Finanzstatistik der Schweiz 2016, Neuchatel: Eidgenössische Finanzverwaltung.

Bulgaria

Score 9

Bulgaria has featured sound budgetary policy for most of the last 20 years. In the two periods when the budgetary position worsened (2009 – 2010 and 2013 – 2014), budgetary discipline was swiftly restored. In 2017 and 2018, small fiscal surpluses were realized. Public debt is well controlled and is gradually decreasing toward 20% of GDP.

Fiscal rules (e.g., a medium-term balanced budget target, a public spending ceiling at 40% of GDP and a public debt ceiling of 60% of GDP) are in place and have helped make budgetary policy sustainable. Adherence to these rules is observed by an independent fiscal council. The council, in operation since 2016, has published a number of opinions and recommendations, including an evaluation of the medium-term budget forecast for 2019 – 2021, the public debt management strategy, the 2019 draft budget and the Ministry of Finance reports on the implementation of previous years' budgets.

While the budgetary process and performance in Bulgaria can generally be considered healthy, the Bulgarian government has developed a practice of accumulating a budget surplus in the first three quarters of the year and then spending almost all of the budget in the last quarter of the year. This has happened in each of the last three years. Such a swing in aggregate spending during the calendar year has made economic development less balanced.

Chile

Score 9

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.

Recent trends have been somewhat more worrisome. The country's budgetary policy has come under pressure due to declines in the price of copper, slowing economic growth, state spending that has risen faster than GDP, the continued presence of a structural deficit, and an increase in debt. This trend forced the Chilean government to significantly lower expenditures of some ministries and public services in the latter half of 2016.

According to the U.N. Economic Commission for Latin America and the Caribbean, in 2018, an increase in tax revenues together with a decrease in public spending (from 4.7% in 2017 to 3.3% in 2018) reduced the fiscal deficit (from 2.8% of GDP in 2017 to 1.9% of GDP in 2018). The fall in public expenditure was mainly related to a fall in current expenditure (from 6.3% of total expenditure in 2017 to 3.0% of total expenditure in 2018), as capital expenditure recorded a recovery (-3.1% in 2017 and 4.8% in 2018). The fiscal policy stance allowed the central government's gross debt to moderate its growth (24.8% of GDP in 2018 compared to 23.6% in 2017).

Citation:
Cf. DIPRES, Política de Balance Estructural:
http://www.dipres.gob.cl/572/w3-propertyvalue-16156.html

Instructions on the implementation of the budgetary law in the public sector (Ley de Presupuesto)
http://www.dipres.gob.cl/597/articles-172486_doc_pdf.pdf

ECLAC: Balance Preliminar de las Economías de América Latina y el Caribe – Dec. 2018.
https://repositorio.cepal.org/bitstream/handle/11362/44326/17/BPE2018_Chile_es.pdf

Denmark

Score 9

Budget policy is guided by fiscal norms: i) the actual budget deficit must not exceed 3% of GDP, ii) public debt must not exceed 60% of GDP and iii) the planned structural budget balance must not display a deficit greater than 0.5%. These norms are part of EU-rules and Danish budget law.

Fiscal policy has satisfied these norms, although in some cases it has come close, and maintained its budget due to ad hoc measures like forward lifting revenue from pension taxation. Both the current balance and the structural balance have been close to the limits. The actual budget deficit is projected to be less than 1.4% and the structural budget deficit to slightly below the norm of 0.5% in 2018. Satisfying the budget norms has been a binding constraint in economic policy for several years.

Analyses from both the Ministry of Finance and the Economic Council show that the criterion for fiscal sustainable public finances is satisfied. This is largely the result of a number of reforms aimed at increasing the labor supply and employment by increasing the retirement age (both early retirement and public pensions), reducing the early retirement period (from 5 to 3 years), and various other reforms of disability pensions, social assistance and study grants.

In short, when compared to other OECD countries, public finances in Denmark are in relatively good shape. However, 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 care). Hence, some pressure on public finances can be expected.

Citation:
Danish Economic Councils, The Danish Economy, Various issues. Latest issue: Autumn 2018 report.

Økonomi og Indenrigsministeriet,, Økonomisk Redegørelse, August 2017.http://www.oim.dk/media/18744/oekonomisk-redegoerelse-august-2017.pdf. (Accessed 4 December 2017)

Prime Minister Lars Løkke Rasmussen's Opening Address to the Folketing on 3 October 20017.http://www.stm.dk/_p_14597.html (accessed 5 November 2017).

Estonia

Score 9

Estonia has followed a strict fiscal policy for decades. As a result, the country has Europe's lowest public debt as a percentage of GDP and is able to meet future financial obligations without placing extra burdens on future generations. Although a small budget deficit has appeared in recent years, it will disappear by 2020 according to current forecasts. The overall tax burden has remained fairly stable, despite the increase in excise duties in recent years.

Government transfers to municipal budgets, which were substantially cut during the economic recession, are being gradually restored. Combined with the radical administrative reform in 2017, which merged small and fiscally vulnerable municipalities into significantly larger entities, this promises to provide broader and better quality public services at the local level. However, the long-term debts of the health insurance and public pension funds pose significant future challenges to the government's ability to secure citizens' welfare while adhering to the principles of fiscal sustainability.

Latvia

Score 9

Latvia's budgetary policy has been recognized as prudent and fiscally sustainable by the European Commission, the IMF, and the OECD. However, achieving medium-term structural-reform goals remains a challenge.

The budget framework and government-debt cap of 60% of GDP, prescribed by the Law on Fiscal Discipline, has been maintained. Latvia remains broadly compliant with the principles of fiscal discipline.

During 2018, Latvia has maintained policy continuity, which has not been impaired by the current election cycle.

In 2015, the budget deficit was 1.3% of GDP, above the target of 1.0%. In 2016, it stood at 0.0%. In 2017, the deficit (0.5% of GDP) was about 0.25% below the projections of the IMF. In addition, during the first quarter of 2018, the government recorded a cash surplus, supported by a strong increase in revenue from income tax, VAT and social security contributions.

Citation:
1. IMF (2018), Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Latvia, Available at: https://www.imf.org/en/Publications/CR/Issues/2018/09/05/Republic-of-Latvia-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-46206 , Last assessed: 28.12.2018.

Netherlands

Score 9

Although budgetary policy has considerably improved over the last few years due to strong economic growth, worries remain over its long-term sustainability. For the fourth year in a row there is a budgetary surplus of 1% of GDP, over €8 billion. Consequently, state debt has decreased to under 50% of GDP, over €400 billion. However, the sustainability index (houdbaarheidsindex), signaling whether or not the government can pay the future costs of care and education is negative (-0.4), the equivalent of €3 billion – barely within the EU-budgetary rules that allow for 0.5% of GDP. The long-term deficit may even increase now that state income from gas exports will stop (due to earthquake risks to the continued natural gas exploitation in the Province of Groningen), and special financial buffers have had to be created for security and border patrols in case of a “hard” or no-deal Brexit. Such additional outlays are being financed through ad hoc “windfalls” in social care, social benefits and low interest rates. Both the Council of State and the Center for Economic Policy Analysis have criticized the government for its expansive budgetary policy due to the of lack state income from gas sales, and because the government’s extra spending on defense, security, care and education violates the prudential budgetary rule (which states that windfalls may not be used to finance new structural policies). The government, however, views its budgetary policy as an investment in future economic growth.

Citation:
Miljoenennota 2018 (rijksoverheid.nl, accessed 24 October 2018)
Volkskrant, De begroting ziet er schitterend uit maar de rekenmeesters zijn kritisch, 18 September 2018
NRC-Handelsblad, CPB oneens met Hoekstra’s begrotingsbeleid, 15 September 2018
R. Gradus and R. Beetsma, “Houdbaarheidssaldo uitstekend kompas voor begrotingsbeleid,” Me Judice, 5 September 2017

New Zealand

Score 9

Budgetary policy is prudent and sustainable. The 2008-2009 world financial crisis ended 14 years of budget surplus. From 2010, the National-led government followed a course of fiscal consolidation. The incoming Labour-NZ First government's first budget was also viewed as restrained and fiscally cautious, with the Finance Minister, Grant Robertson, forecasting a NZD3 billion (billion) surplus in 2018, increasing to NZD7 billion in 2020. Central government spending remained at roughly 28% of GDP. Gross financial liabilities as a percentage of nominal GDP was projected to decrease from 39.7% in 2016 to 39.1% in 2017 to 38.2% in 2018.
The new government's first budget was focused on expanding or rebuilding public services, especially in the health care and education sectors. Major announcements in the budget included a NZD3.2 billion increase in health spending, a commitment to build an extra 1,600 properties for public housing every year (a goal the government missed by almost 1,200 properties in 2018), and cheaper doctors' visits for half a million people (and free visits for those under 14). Early childhood education was projected to receive an extra NZD590.2 million over four years. Further expenditure included NZD284 million for children with special needs and NZD394 million for new classrooms and teachers. The government also allocated NZD450 million for the establishment of new schools.

Citation:
Fiscal Strategy Report 2017 (http://www.treasury.govt.nz/budget/2017/fsr/b17-fsr.pdf) (accessed 21 September 2017).
OECD Economic Survey of New Zealand 2017 (http://www.oecd.org/newzealand/economic-survey-new-zealand.htm) (accessed 21 September 2017).
Government at a Glance 2013 – Country Note: New Zealand (Paris: OECD 2013).

Norway

Score 9

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 over the next few decades. However, the price drop in oil and gas markets led to a significant reduction in state revenue in 2015 and 2016. Due to technological changes and climate change, there is also more uncertainty regarding the long-term viability of oil and gas-based revenues. Fears of stranded assets are growing as carbon pricing approaches and the complexity associated with offshore oil fields could render extraction costs ineffective. However, extraction costs have dropped significantly in Norway, the country's fields are competitive by international standards and the investment climate remains politically stable.

Gas is increasingly important as the production of oil has been in decline over the last few years. For some time, significant drops in petroleum revenue have been expected at least by 2025, requiring significant budgetary changes. The recent oil-price declines have necessitated earlier reforms.

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 oil fund, created in 1990 by the Norwegian parliament as a means to share oil proceeds between current and future generations, and smooth the effects of volatile oil prices. The fund is administered by Norges Bank Investment Management (NBIM), an arm of Norway’s central bank, and invests exclusively in non-Norwegian assets. As the fund has grown, Norway has gradually moved from being a petro-state to being more of an investor state. It might be less exposed to the risk of volatile oil prices, but has become more exposed to volatile financial markets. Since revenues from the fund are used to cover the public budget deficit, the Norwegian economy is increasingly sensitive to volatilities in global financial markets

Public finances remain sound, but are notably more strained. As revenues are expected to decrease, adjusting welfare spending and economic diversification will grow increasingly important. It is expected that marine industries and sea food production will play an increasingly important role for Norway.

Sweden

Score 9

Since the mid-1990s, fiscal, and budgetary discipline has been extraordinarily strong in Sweden and its tight budgetary regime has begun to yield benefits. In the wake of a financial crisis in the early 1990s, maintaining sound fiscal policy has been an overarching policy goal for both center-right and Social Democratic governments. Sweden is one of very few countries that targets a budget surplus and neither government nor opposition harbor any plans to abolish it. In 2016, a revised budget surplus goal of 0.33% was negotiated between the two major blocs in parliament. The agreement also includes a commitment to a long-term reduction of public debt. Thus, while the surplus goal is somewhat relaxed, there is now a stronger commitment to addressing public debt. Indeed, the past three budgets have generated surpluses. Overall, these developments indicate a continuing broad commitment to maintaining fiscal and budgetary discipline.

The budget surplus goal issue ultimately relates to the Keynesianism-monetarism controversy. The government wants to use the budget actively to drive the economy while the coalition of center-right parties in opposition (Alliance) take a somewhat more monetaristic approach. Either way, the fiscal and budgetary regulatory framework helps sustain a course of strong and sustained economic development. Not even the 2008 global economic crisis nor the euro crisis have profoundly disrupted Sweden’s economic growth.

Since the 2014 elections, the issue in this context has been to what degree the two main contenders for power in Sweden (i.e., the four center-right parties that form the Alliance or the Social Democrats with support from the Greens) still unconditionally subscribe to the surplus goal and other aspects of the financial regulatory framework. The period following the 2014 election has been very positive in budgetary terms, with strong and sustained growth. Combined with a few moderate tax increases, this situation has enabled the government to reduce national debt, but also to increase public spending. Thus, current government policies signal a return to conventional Social Democratic economic policy, albeit embedded in a firm regulatory framework. It is too early to judge how the future government formed after the 2018 elections will profile its economic and budgetary policies.

There are only two clouds on this otherwise bright sky. One is the level of private lending which, in light of interest rates rising next year, the National Bank and other financial observers find alarming. The other source of concern is the low rate of inflation, despite very low general interest rates.

Citation:
Brenton, S. and J. Pierre, "Budget surplus goal experiments in Australia and Sweden," New Political Economy 22 (2017):557-72.

Finanspolitiska Rådet (2017). Swedish Fiscal Policy. Fiscal Policy Council Report 2017 (http://www.finanspolitiskaradet.se/download/18.4c8bf10a160291805212159b/1512728204599/Swedish+Fiscal+Policy+2017.pdf).

Finanspolitiska rådet (2018), Fiscal Policy Council Report 2018. http://www.finanspolitiskaradet.se/english/swedishfiscalpolicycouncil.4.6f04e222115f0dd09ea80001437.html

Mehrtens, Philip (2014), Staatsschulden und Staatstätigkeit. Zur Transformation der politischen Ökonolmie Schwedens (Frankfurt/New York: Campus).

Regeringen (2016), Överenskommelse om skuldankare, nytt överskottsmål och förstärkt uppföljning (http://www.regeringen.se/4a7bfa/contentassets/24a388a9a9994e67a706e0b91768bdd2/overenskommelse-om-skuldankare-nytt-overskottsmal-och-forstarkt-uppfoljning.pdf).

Austria

Score 8

Most of Austria's decision-making elite agree on the need to reduce the country's budget deficit. However, given the robust nature of the Austrian economy, at least in the European context, and cross-party consensus regarding most social policies, there is comparatively little incentive to limit expenses. The political parties seemed 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. This may change under the new coalition alliance between the ÖVP and FPÖ. The FPÖ represents a younger electorate of largely non-unionized employees, working outside the government bureaucracies, and may be more tempted to cut through the "red tape" which protects traditional interests.

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 an 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 enacted the 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.

As hopes of significant future economic growth grew increasingly out of reach, contradicting interpretations of Keynesian policies became sharper under the previous government. The SPÖ preferred using the deficit as an instrument to boost economic growth, while the ÖVP argued that – in the long run – deficit spending would result in disaster and proposed introducing a zero-deficit clause into the Austrian constitution. With the SPÖ out of government, the Keynesian tradition is under threat. However, in its first year, the new government has not indicated that it intends to change the budget parameter of its predecessor significantly.

Canada

Score 8

Canada's government is in a relatively strong fiscal position. Its budget deficit as a proportion of GDP is low by international standards, as is its (net) public debt to GDP ratio, which is projected to remain stable over the next five years at around 31%. The fiscal situation is somewhat weaker in certain provinces, where debt ratios range from roughly 3% in Alberta to over 40% in Quebec. and Newfoundland and Labrador.

For the current fiscal year, 2018 – 2019, the Parliamentary Budget Office projects a budgetary deficit of $19.4 billion or 0.8% of GDP up from $19.0 billion in 2017 – 2018. Deficits in recent years have fallen short of the government's fiscal gap projections due to a stronger than expected economy. The PBO considers it likely that the federal debt-to-GDP ratio will drop below the government's target of 31.8% within the next five years. In its most recent 2018 fiscal sustainability report, the PBO estimates that the federal government could permanently increase spending or reduce taxes by 1.4% of GDP (billion in current CAD) while maintaining net debt at its current (2017) level of 31.1% of GDP over the long term. The same cannot be said for long-run provincial fiscal sustainability, however, primarily due to rising health care costs. The same report indicates that, while the growth in health care spending had slowed, subnational governments, which are responsible for the lion's share of spending, will be unable to meet the challenges of population aging under the current policy.

Recent changes to the Financial Administration Act require the government to seek parliamentary approval to borrow in debt markets. In November 2017, the Borrowing Authority Act came into force which sets a maximum amount on the government's total stock of market debt and on borrowing by agent enterprise Crown corporations, and requires the government to report to parliament on the status of borrowing.

Citation:
Department of Finance, Government of Canada, Annual Financial Report of the Government of Canada Fiscal Year 2017–2018 accessible at https://www.fin.gc.ca/afr-rfa/2018/index-eng.asp

Parliamentary Budget Officer, Fiscal Sustainability Report 2018, posted at https://www.pbo-dpb.gc.ca/web/default/files/Documents/Reports/2018/FSR%20Sept%202018/FSR_2018_25SEP2018_EN_2.pdf

Parliamentary Budget Officer, Economic and Fiscal Outlook - October 2018 - Revised Oct. 31, 2018, posted at https://pbo-dpb.gc.ca/en/blog/news/EFO_Oct_2018

Finland

Score 8

The government agenda of the current Sipilä government builds on its predecessors' initiatives, structural policy programs and public-finance adjustment policies. Consequently, the government's economic policy program has aimed at strengthening the economy's growth potential, raising the employment rate, bolstering household spending power and improving international competitiveness. Accordingly, the government is committed to an active fiscal policy that supports economic growth and employment, aims at a reduction of the central government's debt-to-GDP ratio, and tries to strike a balance between long-run fiscal sustainability and the short-term need to support domestic demand. However, the unfavorable economic environment has impeded the government's goals and ambitions. The debt crisis in Europe slowed economic growth, and the government's initial ambition to halt the growth in public debt by 2015 was not fulfilled. The Ministry of Finance's budget proposal for 2019 draws on decisions made in the general government fiscal plan of April 2018. According to estimates in the summer of 2018, the economy is expected to grow rapidly during 2018, after which a decrease in the economic growth rate is expected. The draft budget for 2019 amounts to a total expenditure of €55.1 billion. The budget deficit for 2019 is projected to be €1.7 billion, lower than when the Sipilä government took office (i.e., a budget deficit of €6.6 billion in 2014). The European Commission's 2018 Stability Programme for Finland projected that the debt ratio will fall below 60% of GDP in 2019. Forecasted GDP growth for 2019 is 2.3%, which is a slightly worse than the 2018 forecast of 2.5%.

Citation:
European Commission, "Assessment of the 2018 Stability Programme for Finland",
https://ec.europa.eu/info/sites/info/files/economy-finance/26_fi_assessment_of_2018_stability_programme.pdf
https://vm.fi/artikkeli/-/asset_publisher/valtiovarainministerion-ehdotus-vuoden-2019-talousarvioksi-on-julkaistu

Ireland

Score 8

Current budgetary policy led to current expenditure increasing by 5.4% in 2018. The expectation is that it will expand by 4.1% in 2019. Capital expenditure increased by 29% in 2018 and is forecast to grow by a further 25% in 2019 in line with the National Development Plan 2018 – 2027. The very strong growth in capital expenditure has been predominantly targeted at correcting the current housing shortage. There has been sustained progress toward correcting budget imbalances. The general government budget balance as a percentage of GDP fell to -0.1% in 2018 and is forecast to move to 0% in 2019. The most recent data show that the national debt-to-GDP ratio, which peaked at 120% in 2013, fell to 64% of GDP in 2018. When consideration is given to the government's assets, the net debt position relative to GDP is expected to fall to 55% of GDP in 2019. As a percentage of modified GNI, it had fallen from 97% in 2017 to 91% in 2018 and is expected to fall to 87% in 2019. Given that modified GNI is far more representative of the underlying behavior of the economy, the debt to modified GNI is still excessively high.

The minister for finance indicated in the 2019 budget that €500 million will be allocated to the newly established "rainy day" fund, which will be seeded by a €1.5 billion transfer of funds from the Irish Strategic Investment Fund. This fund is intended to provide money to meet unforeseen contingencies that may arise in the future. Given the potential volatility of corporate tax funds and the increasing dependency of the Exchequer on these funds to finance increased government expenditure, it is believed that a far greater amount of windfall gains from corporate taxation should be allocated to the "rainy day" fund.

Leaving aside the ever-present possibility of adverse external shocks, a risk now facing the Irish economy is that the government, following record tax returns, will encounter increasing demands from public-sector trade unions to increase public-sector expenditure and in particular public-sector remuneration.

Citation:
Department of Finance, Budget 2019.
Irish Fiscal Advisory Council, Fiscal Assessment Report, November 2018.

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 to 9.4% of GDP in 2009. As a result of fiscal consolidation, the deficit dropped to 7.2% in 2010 and again to 5.5% in 2011. In 2014, the European Council adopted a decision allowing Lithuania to join the euro area as of 1 January 2015, in part recognizing its work in regaining control of the deficit. However, despite relatively high rates of economic growth, the 2012 to 2016 government was only able to reduce the budget deficit toward the end of its political term. According to European Commission forecasts, the general government surplus will be around 0.6% in 2018, up from 0.5% in 2017. However, due to tax and pension reforms as well as increases in social expenditure it is expected to go down again to 0.4% in 2019 and 0.1% in 2020. The structural deficit is expected to hover close to 0.5% between 2017 and 2019. Government debt also expanded during the crisis, reaching 39.8% of GDP in 2012 (from a pre-crisis low of 16% in 2008); it is projected to stabilize around 37% to 38% of GDP over the coming years.

Despite these improvements in Lithuania's fiscal performance since the crisis, the country faces a number of challenges in terms of keeping its public finances sustainable. Factors such as projected expenditure related to an aging population, relatively high migration rates, and the vulnerability of its small and open economy to external shocks pose significant risks to the consolidation path projected by the government in its convergence program. The goal of introducing the euro in 2015 preserved the government's determination to maintain the deficit at a level below 3% of GDP, while the fiscal-discipline law provides an incentive to maintain a balanced fiscal policy as the economy keeps growing. Although spending pressures are increasing, it has been difficult to increase total tax revenues (30.19% of GDP in 2017), in part due to geopolitical tensions, the impact of Russia's import ban on the Lithuanian economy, and slow recovery in the euro zone economy, which is the main export market for Lithuanian businesses. Also, the tax reform coming into effect in 2019 will further reduce government revenues due to the easing of the overall tax burden on labor. Geopolitical and social concerns prompted a major increase in defense and social expenditures under the Butkevičius and Skvernelis governments. In 2018, defense spending will for the first time reach 2% of GDP. Also, increases in old-age pensions were implemented in 2018. A 2019 state budget, which was approved by the parliament in mid-December 2018, has a deficit of €1.1 billion, though the general government balance is expected to reach a surplus of 0.4% of GDP in 2019.

Citation:
COMMISSION STAFF WORKING DOCUMENT, country report Lithuania 2017: https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-lithuania-en.pdf
Commission Autumn 2018 economic forecasts - Lithuania: https://ec.europa.eu/info/sites/info/files/economy-finance/ecfin_forecast_autumn_081018_lt_en.pdf

Luxembourg

Score 8

In 2018, government revenue is estimated to be around €24.8 billion, while government spending is around €24.3 billion. Tax revenues increased significantly in the first quarter of 2018. In addition, the public sector took 6.4% more than a year ago.

However, government spending is growing even faster. In the first three months of the year, the public sector spending grew by €4.5 billion, an increase of 8.5%. The Ministry of Finance attributes rising government spending to high investment "with regard to sustainable and qualitative growth.” Compared to the first quarter of 2017, the state made 11.7% more investments. About a quarter of the money is invested in climate and environmental protection projects.

The bottom line of the central administration in the first quarter amounted to €174 million. At the end of the year, the deficit is expected to grow to just under €900 million. If the finances of the social security system and the municipalities are added up, Luxembourg will achieve a total surplus of €333 million in 2018, according to the economic forecast.

The National Finance Council (CNFP) expressed concerns in 2018 that, with policies remaining unchanged, government debt in 2041 will exceed 30% of GDP. This would lead to a debt of 156% of GDP in 2060 and 286% of GDP in 2070.

In 2018, Yves Nosbusch, president of the CNFP, warned that the long-term sustainability of Luxembourg’s public finances is at severe risk. This risk is associated in particular with an aging population, which affects pension and long-term care insurance. According to the study, age-related expenditure would increase by 2.6% per year from 2060 to 2070 and reach 28.8% of GDP in 52 years, compared to only 17% of GDP in 2018.

Citation:
“CNFP warnt vor Anstieg der Staatsverschuldung.” 15 June 2018. http://www.lessentiel.lu/de/wirtschaft/story/CNFP-warnt-vor-Anstieg-der-Staatsverschuldung-19604238. Accessed 23 Oct. 2018.

“Ehrbare Staaten? EU-Nachhaltigkeitsranking 2017.” Stiftung Marktwirtschaft. December 2017. https://www.stiftung-marktwirtschaft.de/fileadmin/user_upload/Pressemitteilungen/2017/Ergebnisse_kurz_Ehrbare_Staaten_2017_12_12.pdf. Accessed 23 Oct. 2018.

Obermayer, Bastian/Obermaier, Frederik (2016): Panama Papers. Die Geschichte einer weltweiten Enthüllung, KiWi-Paperback.

Australia

Score 7

While net federal government debt currently stands at approximately 20% of GDP, the consensus is that Australia has a structural deficit. This means that, averaged over the business cycle, existing revenue streams will not adequately meet ongoing expenditure needs given 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, partially due to an aging population. The combination of weak commodity prices and a real-estate induced recession may lead to a significant deterioration of the fiscal position.

Australia’s fiscal position, while still relatively weak, showed signs of improvement in the review period, following mild improvements in 2017. While the budget remains in deficit, modest expenditure and revenue measures were implemented in the 2017 and 2018 budgets which have moderated the growth of government debt. Rather than explicit measures to increase revenue and reduce expenditure, the key driver of a return to fiscal balance is bracket creep, whereby non-indexation of tax thresholds result in a rise in the average tax rate on income.

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Czechia

Score 7

Improved economic performance enabled the Czech government to retain its objective of broadly balanced budgets and reduced public debt while allowing some expansion of domestic demand. For the first time since 1994, and despite original plans for a deficit, Czechia ran a fiscal surplus in 2016. Largely due to the strong showing of tax revenues, the general government fiscal surplus further increased in 2017 and was stabilized at about 1.5% of GDP in 2018. Public debt has fallen from 44.9% of GDP in 2013 to 34.7% in 2017 and continued to decline in 2018, remaining among the lowest in the EU and well below the debt limits of 55% and 60% of GDP as defined in the 2017 fiscal responsibility law.

After years of controversy, the government won approval for the Act on Fiscal Responsibility in January 2017. This act sets debt limits for all tiers of government, introduces a central government expenditure ceiling and created an independent Fiscal Council (Národní Rozpočtová Rada, ÚNRR) However, the appointment of the latter's members progressed slowly, so that it started its work only in 2018. The Council has criticized the small central government deficit envisaged in the 2019 budget for being pro-cyclical and has called for leveraging the current economic prosperity to create fiscal leeway for hard times.

Germany

Score 7

For Germany, the 2009 global recession and its aftermath implied higher budget deficits and gross public debt following revenue shortfalls, anti-crisis spending packages and bank bailout costs. Since then, however, Germany's budgetary outlook has considerably improved. Germany's debt-to-GDP ratio has continued to decrease from 80.1% in 2010 to (an expected) 59.9% at the end of 2018, just below the Maastricht threshold of 60%. This decrease resulted from surpluses in the general government balances since 2010, stable growth, strong employment growth and historically low government bond interest rates. In addition to this favorable environment, a constitutional debt limit was introduced (Schuldenbremse) that restricts the federal government's cyclically adjusted budget deficit to a maximum of 0.35% of GDP and requires German states to maintain balanced cyclically adjusted budgets from 2020 onwards.

The costs associated with the influx of refugees were a significant driver of government expenditures in 2015 and 2016. Since then, a strong decline in the numbers of refugees arriving in Germany and the relatively successful labor market integration of refugees, these costs have been lower than expected over the last couple of years.

While the federal budget remains balanced, uncertainties concerning the medium- to long-term budgetary outlook have increased. Germany's aging population will mean that recent increases to welfare spending (e.g., increased pension payments for mothers and allowances for nursing care) combined with very dynamic increases in pension and health care expenditures will pose a significant challenge to future federal budgets. The demographic challenges for fiscal sustainability will grow substantially toward 2030 as the baby-boomer retirement wave peaks. Simulation studies indicate that, without substantive reforms (e.g., an increase in the state pension age, expenditure cuts and higher contribution rates), budgetary policy will be far from sustainable over the coming decades. The main reasons are substantial projected deficits in the pension and health care systems, which would have to be balanced by federal payments to the social security systems.

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Israel

Score 7

Israeli's history of successful budgetary reform continues to contribute to the stabilization of the Israeli economy. Along with prudent monetary policies, budgetary reform measures helped the country weather the recent global economic crisis relatively successfully.

After the 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. Strict budgetary-discipline laws were enacted: The Budget

Foundations Law set scrupulous spending procedure regulations and implemented deficit-reporting requirements, and 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. Consequently, fiscal power was centralized, giving the Ministry of Finance’s budget department the power to impose a policy of budgetary discipline.

Two crucial additional tools, the Arrangements Law (Hok Ha-Hesderim) and the Budget Deficit Reduction Law, redefined the financial and economic structure of the Israeli government. The Arrangements Law is an omnibus law passed in parallel with each budget, consisting of numerous restrictions and amendments designed to secure the state’s financial goals. Since 2009, the budget has been converted to a biennial budget plan, which many regard as having a positive influence on planning capabilities. Though in September 2017 Israel’s Supreme Court ordered the government to either formally legislate the change to biennial budget or return to an annual budget plan.

Regarding the budget deficit, according to recent preliminary reports (October 2018), the Israeli government has exceeded the deficit ceiling set by the Budget Deficit Reduction Law following a jump of almost one percentage point (from 2.5% to 3.3%) in the deficit. If Israel exceeds the deficit ceiling, Israel’s credit rating might suffer, with serious repercussions on the interest rate of its external deficit.

Citation:
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Malta

Score 7

Budgetary developments since 2013 have demonstrated that Malta is set to meet most standards of financial sustainability. As of June 2015, Malta was no longer subject to the EU’s Excessive Deficit Procedure. Indeed, deficit levels have been decreasing steadily; the deficit fell to 2.0% of GDP in 2014 and to 1.5% of GDP in 2015. Significantly, a surplus equivalent to 1.0% of GDP was registered in 2016, and increased substantially to 3.9% of GDP in 2017, but is expected to decline to 1.1% of GDP for 2018. The European Commission has found Malta’s 2019 budget to be line with the euro area’s Stability and Growth Pact, and the country is of only 10 EU members to have passed the fiscal test.

The government is expected to maintain a surplus between 2018 and 2021. The introduction of legislation to enhance the transparency of government finances represents an additional step forward. However, the Malta Fiscal Advisory Council has advised the government to remain vigilant in view of rising forecast expenditures. The 2018 European Commission Staff Working Document on Malta's Country Specific Recommendations also notes that public expenditure in the healthcare and pension system is expected to increase at a faster rate than that experienced by other member states, thereby creating challenges to fiscal sustainability. In terms of pensions, the document advocates increasing the retirement age and reducing incentives for early retirement. New measures in the 2019 budget are expected to reduce the fiscal surplus by 0.3% of GDP, with additional measures including the rent subsidy and free transport expected to reduce it by a further 0.2%. In all, a net surplus-decreasing impact of 0.6% is envisaged, a figure the EU Commission has deemed plausible. The government has established a Public Sector Performance and Evaluation Directorate within the Ministry of Finance, and a comprehensive spending review process has been introduced with the aim of improving expenditure efficiency. The 2018 IMF Country Report recommended that the revenues generated from the Individual Investor Program (IIP) be managed with prudence, given that they might be volatile and unsustainable in nature.

While Air Malta, a state-owned enterprise, continues to face challenges, it has recently enjoyed a stronger competitive edge than has been true for several years. Meanwhile, the country's energy provider, Enemalta, has been given a positive review by the rating agency Standard and Poor in view of its gradual reduction of long-standing government-guaranteed debts.

Citation:
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National Reform Programme Malta 2018 p.3
IMF Country Report No.18/20 p.7
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The Malta Independent 21/08/2018 Air Malta flights will now be sold on Ryanair after joint-venture agreement
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Portugal

Score 7

The budget deficit for 2017 stood at 3% of GDP. This is only the fourth time that the deficit has been at or below 3% since 1995 – with 2016 and 2017 accounting for two of these four years. However, this 3% deficit marks an increase vis-à-vis to 2016's record low.

The 3% budget deficit in 2017 was inflated by a one-off capitalization of the public bank, Caixa Geral de Depósitos (CGD). Without this injection of capital into the CGD, the deficit would have stood at 0.9% – which would have been the lowest level since democratization.

These positive results have continued into 2018, with the independent Council of Public Finances estimating a deficit for 2018 of 0.5% – a result that is better than the government's own forecasts.

The decrease in the budget deficit has affected public debt. While the absolute level of public debt remains very high, standing at 124.8% of GDP in 2017 (only lower than Greece and Italy in the European Union), this is a 4.3 percentage point improvement vis-à-vis 2016.

These positive results have helped Portugal regain international credibility, as evidenced on two levels. First, in terms of the evaluation of credit agencies. During the period under review, Portugal's rating was raised to investment grade by all three big credit agencies, with Fitch raising the rating in December 2017 and Moody's in October 2018. This marked the first time since July 2011 that Portugal had received an investment grade rating from all of the major credit agencies.

The second level is the increasing political recognition afforded to Portugal's Minister of Finance, Mário Centeno. After being dubbed the "Cristiano Ronaldo of the Ecofin" in May 2017, Centeno was elected president of the Eurogroup by the finance ministers of euro zone member states in December 2017 – a result that is inevitably bound to Portugal's improving budgetary consolidation.

While Minister of Finance Centeno enjoys a good reputation regarding budgetary matters both within and beyond Portugal, it should be noted that there are several so-called cativacoes within the budget which refer to funds that have been allocated but cannot be spent..

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Slovakia

Score 7

Slovakia managed to reduce the general government fiscal deficit from about 8% of GDP in 2009 to 3% in 2015 and 1.7% in 2016. The deficit went further down in 2017 and fell to about 0.8% of GDP in 2018. While the consolidation of the budget has been favored by strong and higher-than-expected economic growth, the government has also succeeded in limiting expenditure growth. In the period under review, it continued its “Value for Money” project and initiated a third round of spending reviews covering poverty and social exclusion, agriculture, the public wage bill and health care. The new Minister President Pellegrini has stuck to the third Fico government’s commitment to a balanced budget. As a matter of fact, the better-than-expected economic performance has enabled the government to pass a balanced budget for 2019, one year earlier as foreseen in the 2016 government manifesto. While Slovakia has a relatively high public debt, risks to the public finances are largely long-term and related to population aging and the lack of pension and health care reform. The budgeting framework still shows certain gaps in terms of coverage, time horizons and reliance on cash accounting.

Citation:
European Commission (2019): Country Report Slovakia 2019. SWD(2019) 1024 final, Brussels, 19-20 (https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-slovakia_en_0.pdf).

Spain

Score 7

The budget for 2018 was finally approved in June, after a complex set of political negotiations. It was the third year in a row in which budgetary policy had somewhat softened austerity measures, stretching the timeline of the European Semester budgetary plan. Except for some minor changes, the new socialist government that took office in early June accepted a budget that had been prepared by its conservative predecessor.

Driven by the cyclical improvement of the economy, declining interest expenditures and a slight increase in tax collections, the deficit shrank from 4.5% of GDP in 2016 to 3.1% of GDP in 2017. The 2018 budget forecast a deficit of around 2.7% for the year (although the Bank of Spain warned that it could rise to 2.8%). Despite this reduction, the deficit continues to be higher than in the rest of the European Union's countries. The public-debt-to-GDP ratio (98.1% in 2018) is the sixth-highest in the EU (after Greece, Italy, Portugal, Belgium, and France), and has been only slightly reduced since the worst years of the crisis. Nevertheless, during 2018, Spain's risk premium fell to its lowest level since early 2010.

The draft budget for 2019 (which was ultimately not passed, leading to snap elections in early 2019) included a generous rise in public spending (in the areas of minimum wages, pensions, unemployment benefits, housing, paternity leave and increased investments in education and science) without an equivalent increase in revenues (since the increases that were introduced seemed unlikely to be realized). Thus, it would be premature to conclude that Spanish budgetary policy has reached the point of fiscal sustainability, particularly if the slowdown in economic growth forecast for 2019 is taken into account.

Citation:
EC(2018) Interim Economic Forecast: A solid and lasting expansion: https://ec.europa.eu/info/business-economy-euro/economic-performance-and-forecasts/economic-forecasts/winter-2018-economic-forecast_en

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Turkey

Score 7

General government revenue, according to the IMF (2018), decreased from 32.8% of GDP in 2016 to 31.2% in 2017, and is expected to decrease to 30.3% of GDP in 2018 and further to 29.9% during 2019. On the other hand, general government expenditures decreased from 35.1% in 2016 to 33.4% during 2017, and is expected to increase to 34.4% in 2018 and further to 35% in 2019. As a result, the fiscal deficit of the general government – after declining from 2.33% in 2016 to 2.27% of GDP in 2017 – is expected to increase to 4% of GDP in 2018 and further to 5.1% of GDP in 2019.

During the period 2012 – 2015, the government maintained fiscal discipline by keeping the general government deficit at 1.5% of GDP. But after the failed coup attempt of 15 July 2016, the government adopted an expansionary fiscal policy approach and government deficit as a percentage of GDP increased to 2.3%. Constitutional referendum was held on 16 April 2017 and general elections on 24 June 2018. To please voters during the parliamentary elections in particular, the government adopted an expansionary fiscal policy approach, increasing wages and social transfers, and purchases of goods and services. In addition, temporary tax reductions, continued minimum wage subsidies and an employment incentive scheme were provided. According to the IMF (2018), the fiscal impulse is estimated at close to 1% of GDP in 2017. Additional incentives were introduced during 2018. Furthermore, contingent liabilities arising from public-private partnership (PPP) projects are not included in the fiscal balances. As a result, the fiscal deficits reported above are underestimates. According to the IMF (2018), the investment size of PPP projects concentrated in the public transport, energy and health care sectors amount to $61 billion, and 60% of these PPP projects are under construction. Contingent liabilities could arise from demand, exchange rate, investment guarantee and contract termination clauses mainly issued by Turkey’s Ministry of Treasury and Finance.

As a result of the above developments, gross public debt totaled 28.3% of GDP in 2016, 28.3% of GDP in 2017, and the ratio is expected to increase to 32.3% in 2018 and 33.6 in 2019.

Citation:
International Monetary Fund (2018a) ‘World Economic Outlook Database’, Washington D.C.: IMF (October)

International Monetary Fund (2018b) ‘Turkey 2018 Article IV Consultation-Press Release: Staff Report; and Statement by the Executive Director for Turkey’, Washington D.C.: IMF (April)

United Kingdom

Score 7

The United Kingdom is fiscally a highly centralized state. As such, central government has considerable control over budgetary policy. Most public spending is directly or indirectly controlled by the central government, with 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.

Under previous Labour governments, the “golden rule” of UK fiscal policy was to limit deficit spending to investment over the business cycle. However, public spending as a proportion of GDP increased during the 2000s and, in hindsight, was too pro-cyclical. In 2009, adherence to fiscal rules was abandoned to cope with the consequences of the crisis. There is now a fiscal council, the Office for Budget Responsibility, and fiscal rules, including provision for surpluses in “good times,” are being in a new Charter for Budget Responsibility.

With reasonably good economic growth – especially in comparison to some other European economies – estimated at 1.3% of GDP in 2018, government debt peaked at 85.2% of GDP in 2018 and is forecast to fall to 83.7% of GDP in 2019/20 with an ongoing declining trend. Nevertheless, this is still less than previously expected, borrowing is now expected to be £11.6 billion lower in 2018/19 than was forecast in the 2018 spring statement. That is equivalent to 1.2% of GDP. Chancellor Hammond explained that the government will meet its long-term financial targets three years early, as the current deficit will fall to 1.3% of GDP in 2021. Low interest rates and the extensive purchases of public debt by the Bank of England through its quantitative easing program enable the United Kingdom to avoid paying a high price for the period of high debt, with debt service payments only marginally higher than during the 2000s.

All these figures are, however, based on the expectation of some sort of Brexit deal that will safeguard the economic structures on which the United Kingdom's economic success relies. In his budget speech, Chancellor Hammond announced his readiness to boost the spring statement to a "full fiscal event" if necessary, a phrase that can easily be read as the announcement of an emergency budget in case of a hard Brexit.

Citation:
Autumn Statement 2018: https://www.gov.uk/government/publications/budget-2018-documents
https://www.gov.uk/government/speeches/budget-2018-philip-hammonds-speech

Belgium

Score 6

Belgium's public debt, because it is currently above 100% of GDP, is in the preventive arm of the Stability and Growth Pact, and subject to the debt rule of the European Semester. This requires that the government prioritize public debt reduction. Similar to several other EU member states, this translated into cuts to public investments, health care and pension spending, and sluggish improvements in the education system and environmental protections.

It is fair to say that Belgium is thus well on track to maintain its solvency. However, it is doubtful that its current approach is sustainable – given that growth is anticipated to remain rather sluggish (1.5% – 1.6% over the next five years), productivity is not improving, and the gap between the supply and demand of skills in the labor market is widening – potentially putting the competitiveness of the country at risk. The Council of Europe, in its July 2018 recommendations (paragraph 19), states that "The proportion of graduates in science, technology and mathematics is one of the lowest in the [European] Union and shortages in these fields could become a major barrier to [economic] growth and innovation." The Belgian Sustainable Development Indicators point to a structural and continuing decline in lifelong education since 2004, in contrast with the rest of the EU28). It is also unclear whether the pension system will still be able to protect those currently under the age of 40, as it has supported the two or three older generations.

Citation:
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Croatia

Score 6

When Croatia joined the European Union in July 2013, it was almost immediately placed under the EU's excessive deficit procedure. However, successive governments have managed to reduce the general government fiscal deficit from a peak level of 7.8% in 2011 to about 1% in 2016. In 2017 and 2018, the general government even ran small surpluses. Since 2016, Croatia's relatively high public debt has fallen. As a result of these improvements, Croatia was able to exit the excessive deficit procedure in June 2017. The fiscal improvements in 2017 and 2018 have largely stemmed from the higher-than-expected GDP growth and the decline in interest payments. In 2017, the government paid HRK 9.7 billion for interest costs – HRK 2.3 billion less than in 2015. The government has failed to reduce the various expenditures that, according to leading Croatian economists, are associated with clientelistic arrangements. Further concerns about the medium-term sustainability of budgetary policy have been raised by the slow progress with amending the 2011 Fiscal Responsibility Act and with improving budgetary planning as recommended by the European Commission and the IMF for some time.

Cyprus

Score 6

The implementation of the 2014 Law on Fiscal Responsibility and Fiscal Framework launched a budget design process that meets strategic targets set by the government. This led the administration to gradually acquire strategic planning capacities. Provisions of the law for oversight (by the Minister of Finance) from design to implementation aim to reduce the risk of a new economic crisis. Prospects for 2019 appeared positive, with the maintenance of large fiscal surplus and reduction of the public debt, albeit from buoyant revenues.

Post-program surveillance reports included a number of warnings against loosening the strict spending discipline and for keeping public wages tuned to GDP growth and more structural reforms to enhance reviews of spending. A 2018 amendment provided for existing salary cuts in the public sector to be gradually reversed by January 2023.

The aim of the 2019 budget is to consolidate growth and reduce the public debt, which, after falling below 100% in 2018, has risen to 104% after the government issued new bonds to support the Cooperative Bank. A modest budgetary impact is expected from the gradual reestablishment of public sector salaries which began in 2018, the reduction or cancelling of various taxes, and other measures.

GDP was expected to grow by 4% in 2018 compared to 4.2% in 2017 and by 3.8% in 2019. The debt-to-GDP ratio, which jumped to 104% in mid-2018, was expected to recede again below 100% in 2019, according to the Finance Ministry. The ministry projects fiscal surplus at 3.0% of GDP for 2019 compared to above 1.0% in 2018.

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2. IMF, Cyprus: Staff Concluding Statement of the 2018 Article IV Mission, 5 October 2018, https://www.imf.org/en/News/Articles/2018/10/05/mcs10518-cyprus-staff-concluding-statement-of-the-2018-article-iv-mission
3. EC-ECB Staff statement following the fifth post-programme surveillance mission to Cyprus, https://www.ecb.europa.eu/press/pr/date/2018/html/ecb.pr180928.en.html

France

Score 6

France’s budgetary situation is still unsatisfactory with regard to European commitments and long-term sustainability. Over recent years, many new commitments (public servants’ salary increase, security or military expenses, disputable rescue operations) further increased public spending in spite of public declarations. The number of civil servants, which had slightly decreased in the Sarkozy era (2007 – 2012), has grown again. The Hollande administration made some efforts to reduce the structural deficit (2012 – 2014) but then abandoned the objective to balance the structural budget.

Faced with this dubious situation, Macron and his government have decided to stick to the EU obligations on budgetary consolidation, and make sure that France respects its commitments in 2017 and following years. The president’s aim was not only to return to sound public finances and regain financial room for maneuver, but also to recover lost credibility in Europe, a pre-condition for any ambitious proposal to reform the European Union or to influence the European Union’s policy agenda.

Macron’s commitment is clear, but his hopes that economic growth would support his strategy have been disappointed. The economic growth forecast for 2018 has been lowered from an expected 2% to 1.7%, which is still an optimistic estimate. Consequently, the 2019 budget will be squeezed between past commitments (e.g., the elimination or lowering of individual and company taxes) and the desire to increase salaries (e.g., through changes to taxes and social contributions). Furthermore, the cost of the “urgency measures,” proclaimed on 10 December 2018 in order to meet the social protest of the “yellow vests” movement, is another impediment to a balanced budget. Given that very few sustainable economies have been realized as the administration reform is stagnating, the structural budgetary deficit will barely diminish, and the budget deficit will probably exceed the 3% limit of the European Stability and Growth Pact.

Greece

Score 6

After 2015, a tumultuous year in which government instability and a fruitless national referendum negatively affected public finances and the budget deficit reached 5.6% of GDP, Greece made progress on fiscal sustainability. A budget surplus was attained for two consecutive years: 0.5% in 2016 and 0.8% in 2017 (2.2% excluding debt repayments). Notwithstanding, the country's public debt remained at prohibitive levels (180% of GDP in 2017).

Turning from a large deficit to a surplus over a short time span resulted from two government actions. First, in 2016 and 2017 tax laws were changed in order to impose historically high taxes on middle- and high-income individuals and companies. Second, the post-2015 government continued a practice commonly adopted by previous governments: it grossly delayed payments or actually refrained from paying private suppliers who had already delivered goods and services to Greek ministries and state agencies. Increased taxation and delays in state payments nearly collapsed some private businesses (outside the thriving tourist sector; in the industrial and commercial sectors).

The state budget is constrained not only by the continuing economic crisis (Greece remains unable to borrow funds on the international markets), but also by the chronic spiraling of pension expenditures. Greece dedicates 55% of all social protection expenditures to pensions (EU average: 39%, latest data available from 2015). Facing periodic military threats from Turkey, Greece's budget also must dedicate large funds to defense expenditure. This constitutes 2.4% of Greece's GDP (among NATO member states, a percentage share surpassed only by the United States).

In the period under review, the government distributed a one-off cash allowance to low-income households in order to appease its electoral clientele. This policy measure was taken against the policy advice of the country's lenders, who would have preferred that the government revive the private economy by paying arrears owed to private suppliers.

In summary, in the period under review, the government followed the fiscal policy guidelines contained in Greece's Third Economic Adjustment Program (2015-2018), raising taxes and achieving a spectacular 3.5% primary surplus (versus a target of 1.75%) in the 2017 budget – mainly by raising taxes for the middle classes. However, this came at a heavy price for the economy, which grew just 1.4% against a target of 2.7%.

Citation:
The general government primary balance utilizes a differing methodology for calculating categories of revenue and spending from those outlined in the bailout program.
Information on the Greek state budget is drawn on statistical tables available by https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina200&plugin=1Eurostat
Eurostat is also consulted for public debt and government expenditure data.

Iceland

Score 6

The 2008 economic collapse dramatically increased the country’s foreign debt burden. General government gross debt rose from 29% of GDP at the end of 2006 to 95% in 2011. Though it gradually decreased to 37% by the end of 2018 and is projected to further decline to 24% by 2023. Reflecting a reduction in the public debt-to-GDP ratio, which stems in part from a fairly rapid expansion in output since 2011, while interest payments on the public debt have declined from 4.5% of GDP in recent years to 3% in 2018. However, in late 2018, there were indications that excessive wage increases were beginning to boost inflation and weaken the currency, which could increase the debt burden, other things being equal. Even so, according to the IMF, Iceland’s foreign debt burden should remain sustainable. Nonetheless, fiscal sustainability remains a serious concern for the government given the dire financial situation of several key public institutions, such as the State University Hospital.

Three comments are in order. First, Iceland’s public debt burden is understated in official statistics because unfunded public pension obligations are not included, which is rare in OECD country data. Second, while the left-wing 2009 – 2013 government increased fishing fees significantly and budgeted for further increases, the center-right 2013 – 2016 government reversed course and reduced fishing fees against IMF advice, a policy continued by the center-right 2016 – 2017 government and the left-right government formed in late 2017. This reversal reflects a change in public expenditure and tax policy from a progressive to a regressive stance. Third, many public institutions remain in a dire financial situation, including the State University Hospital, schools and universities, and the State Broadcasting Corporation (RÚV). Fiscal balance is not on a firm foundation when vital public institutions and infrastructure continue to suffer from long-standing financial neglect.

Citation:
International Monetary Fund, 2018 Article IV Consultation, IMF Country Report No. 18/318, November 2018, https://www.imf.org/en/Publications/CR/Issues/2018/11/14/Iceland-2018-Article-IV -Consultation-Press-Release-Staff-Report-Staff-Statement-and-46357. Accessed 18 December 2018.

Italy

Score 6

Italian governments have struggled to continue the budget consolidation process begun by the Monti government during an era of prolonged economic stagnation. Fiscal policies have gradually reduced yearly deficits and produced a strong primary surplus. Yet because of the recession environment, attempts to reduce the huge debt stock (by selling, for example, public properties or stocks of state-owned companies) have had little success or have been postponed. The improved climate on the international markets and European Central Bank policies have yielded a sharp decline in interest rates for Italian long-term treasury bonds. This has eased the country's budgetary pressures. After a modest recovery in 2016, economic growth accelerated through 2017, which has slowed the growth in public debt. However, the previous government's promise that the ratio of public debt-to-GDP would start declining in 2016 will probably only become true in 2018 and may even increase again in 2019 – as the new government has proposed increasing the deficit in future, while economic forecasts predict lower GDP growth.

Fiscal policies for 2017 have benefited from the improved economic conditions. The government, in close coordination with the European Commission and taking advantage of the flexibility allowed by the European Union for countries introducing significant structural reforms, has pursued a path of modest fiscal consolidation balanced by measures to sustain economic recovery. Tax reductions and incentives for entrepreneurial activities have only partially been offset by reductions in public expenditure. In general, cuts to public expenditure, proposed in the government's spending review, have been implemented more slowly than initially proposed. This has been due to resistance from interest groups and fear that such cuts would have recessionary effects. The pace of privatization of public assets has been slower than anticipated.
The vast majority of regional and municipal budgets are fiscally sustainable, though not all.
The new coalition government has decided to diverge significantly from this path, and plans to increase the public deficit for 2019 to 2.4% (contrary to previous agreements with the European Commission) and to postpone reducing public debt to 2020 or 2021. For a final decision, however, we will have to wait for the end of the budgetary process.

Citation:
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Mexico

Score 6

Given the country's history of severe macroeconomic imbalances until the 1990s, 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 recent financial difficulties have also been a cautionary tale to the Nieto administration of the dangers of fiscal profligacy. Consensus among the major political actors is significant on this matter. In fact, 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.

However, Mexico's fiscal stability continues to be under threat as a result of the collapse in global oil prices through 2014 and 2015. Although most oil production is consumed domestically, oil exports are a significant source of public revenue given the state-owned structure of Mexico's oil industry. The recent fall of oil prices have motivated tax changes and the reduction of energy subsidies. This has been partially relieved with financial instruments that guarantee a minimum price. This strategy was applied over the last two years and there are no signs that it will be discontinued in 2019 by the new government. The minimum crude oil price has increased considerably from $46 per barrel last year to $63 per barrel this year.

One key shortcoming of the current administration is the lack of consistency between planning and implementation. In 2015, the government announced a spending cut but actual spending increased 5% in real terms. There are few reasons to believe that spending cuts for the coming years will be implemented: according to Mexican researchers, public spending has increased more than 4% every year in real terms since 2012. Even when the goal has been to maintain a primary surplus at the beginning of the year, the trend is reversed by the end of the same year. That is, spending surpasses revenues even before interest payments.

Government debt has increased more than 10% during the Peña Nieto administration. Moreover, not all debt is clearly accounted for: there are items classified as "non-oil revenues," non-tax revenues, and "returns" (aprovechamientos), ambiguous categories that include worker pensions and Pemex assets. These spending patterns along with growth deceleration have increased the value of sovereign debt as a share of GDP. Rating agencies lowered Mexico's sovereign credit outlook from stable to negative in 2016, which will further increase the country's interest payments. In 2018, Mexico paid more toward debt interest payments than toward capital.

A second key shortcoming of Mexican budgetary policy is the opacity surrounding spending decisions. More than half of spending increases have gone to subsidies and transfers, surpassing the amount approved by Congress by more than 10%. Of this increase, around 40% was spent in programs without monitoring, audits or impact evaluations. This opacity allows for the political use of resources, which may partly explain state-level variations on per-capita spending that seem to be associated with changes in the party holding the executive office. Opacity in public spending was partially addressed in 2016 with the creation of the National Anticorruption System, a set of laws that constrains federal and local authorities to prosecute and punish acts of corruption. In 2017, the Ley General de Responsabilidades Administrativas (General Law of Administrative Responsibilities) was published, and it increases sanctions and oversight on private actors that participate in public biddings. However, it remains to be seen if public officials will adequately enforce this law in the coming years, especially as next year's election campaigns will further reduce the transparency around public budget allocations.

The next undersecretary of expenditures of the Ministry of Finance and Public Credit (SHCP), Gerardo Esquivel, has stated that the budget for 2019 will be responsible and promised that the country's fiscal stability will be maintained. Analysts see this as the government trying to boost confidence in the economy, as investors are an important factor in GDP growth.

Citation:
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Poland

Score 6

Benefiting from the strong economic growth and higher than expected revenues, former Minister of Finance Mateusz Morawiecki, the current prime minister, succeeded in bringing the general government fiscal deficit down from 2.7% in 2016 to about 1.5% in 2017, a much stronger showing than originally expected. In 2018, the general government fiscal deficit declined further. However, the structural – that is, cyclically adjusted – fiscal balance has remained broadly stable since 2016, and does not meet the medium-term objective of -1% of GDP. There are also concerns about the medium-term budget developments. One reason for this is the strong increase in social spending and the lowering of the retirement age under the PiS government. A second risk is related to EU transfers under the Common Agricultural Policy, and from the structural and cohesion funds. These transfers will shrink due to improved regional development and might decrease further if cuts in transfers are embraced as a means to sanction the violation of EU law. Finally, Poland's fiscal framework is weak. Its credibility has suffered from the modification of the official expenditure rule in December 2015 and the fact that the country, contrary to almost all other EU countries, still does not have an independent fiscal council.

South Korea

Score 6

South Korea's public finances remain sound, and public debt levels remain low in comparison to those of most other OECD countries. National debt as a share of gross domestic product (GDP) was 40.4% in 2018, up from 39.5% in 2017. During the period under review, Korea ran a healthy primary surplus of 1.3% of GDP, giving the government the leeway to implement its plans to increase public investment and social spending. Indeed, in 2018 the government budget saw its biggest increase in

10 years amid a cooling of the global economy. However, while debt at the national level is sustainable, many local governments and many public enterprises are struggling due to insufficient revenues.

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Hungary

Score 5

In the run-up to the 2018 elections, Hungary’s fiscal policy has turned pro-cyclical in 2017 and 2018. Despite the strong economic growth and buoyant tax revenues, the general government fiscal deficit rose from 1.6 % of GDP to almost 2.5% in 2018, and only a moderate improvement is projected in the next years. In 2018, Hungary’s fiscal deficit was one of the highest in the European Union, and public debt has also remained high for Hungary’s level of development. The structural deficit rose by 2 percentage points of GDP between 2016 and 2018. Against this background, the Council of the EU launched a significant deviation procedure addressed to Hungary in June 2018. The Orbán government’s fiscal policy has also been criticized for its lack of transparency. Budgets are being passed already in May or June, when important information about the coming year is not yet available. Eurostat has continued to criticize the official Hungarian data on the public debt for not including some relevant transactions, most notably those by the state-owned Eximbank and the various foundations of the Hungarian National Bank.

Citation:
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Slovenia

Score 5

The Cerar government succeeded in bringing the fiscal deficit down from 3.4% of GDP in 2014 to 0.8% in 2017, thus exiting the European Commission’s excessive deficit procedure in June 2016. The budget for 2018 foresaw a small surplus of 0.1% of GDP. As a matter of fact, the surplus turned out to be about four times higher. The improvement in the fiscal stance has largely stemmed from the recovery of the Slovenian economy and a number of one-off measures such as freezes on wages and promotions in the public sector. In part due to the country’s solid economic growth, trade unions were less cooperative in 2017 and 2018 in particular, when they rejected an extension of wage restraints in the public sector, and widespread public sector strikes in February 2018 contributed to the resignation of Cerar government in

March 2018. Slovenia's structural deficit has remained relatively high, the debt-to-GDP ratio, while declining since 2016, still exceeds 70%, and the fiscal pressure associated with an aging population is relatively high. In order to stress its commitment to a sustainable budgetary policy, the National Assembly, in line with the EU's Fiscal Compact, enshrined a "debt brake" in the constitution in May 2013. However, the corresponding legislation was not adopted until July 2015, and the government and opposition proved unable to reach a consensus on selecting the three members of the Fiscal Council (which is tasked with supervising fiscal developments) until late March 2017. In September 2018, the Fiscal Council warned of a possible double-digit GDP deficit in the next few years, if the coalition agreement of Šarec government is fully implemented.

Romania

Score 4

Romania's general government fiscal deficit continued to grow in 2018. Eventually exceeding 3% of GDP, it was the second highest in the European Union. The deficit was caused by both by the government's tax cuts and its profligate public spending. In the first half of 2018, the deficit was substantially higher than planned. This prompted the Council of the European Union to launch a significant deviation procedure addressed to Romania in June 2018 and led the government to pass two budget amendments in September and November 2018. The original 2018 budget, as well as the two budget amendments violated several national fiscal rules. As in previous years, the government also failed to send the update of the medium-term fiscal strategy to parliament by the statutory August deadline. While the debt-to-GDP currently stands at below 40%, it is likely to increase and to go beyond the 60% reference value by 2029, if budgetary policy continues the course adopted since the 2016 parliamentary elections.

Citation:
European Commission (2019): Country report Romania 2019. SWD(2019) 1022 final, Brussels, 22, 24-26 (https://ec.europa.eu/info/sites/info/files/2019-european-semester-country-repor t-romania-en.pdf).

United States

Score 4

The condition of budget policy in the United States is 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 a manageable 2.5% of GDP by 2015, recovery was too slow to stimulate vigorous economic growth. At the same time, long-term deficits are by all accounts seriously beyond acceptable levels. As the Congressional Budget Office has testified, "federal debt appears to be on an unsustainable path." The primary cause of long-term deficits, in addition to the severe limits on revenues, is the growth of the elderly population and the generous terms of the Medicare (health care for the elderly) and Social Security (retirement) programs.

In 2018, the annual deficit jumped by about 17% over the previous year. Under current policy, the deficit is projected to increase over the next ten years and reach 5.7% of GDP by 2028 – with spending on Social Security, Medicare and Medicaid now accounting for about half of the federal budget. Overall, Trump administration policy changes have exacerbated the country's long-term fiscal challenges. Furthermore, Congress is increasingly less able to deliver a budget on time. A massive disagreement between Congress and the president over immigration and the Deferred Action for Childhood Arrivals (DACA) policy led in January 2018 to a failure to pass the budget for government operations. As a result, the government was shut down for four days.

Japan

Score 2

Gross public indebtedness in Japan amounted to about 240% of GDP in 2017, the highest level among advanced economies. The primary balance also continued to show a strong deficit of about 4% in 2017, with around 3.3% expected in 2018. Though these numbers are not expected to rise much further in the near future, their persistence is alarming. Because the goal of achieving a primary budget balance by 2020 has become unfeasible, the government moved that date forward to 2025 in its long-term economic policy plan released in June 2018.

Nominal interest rates remain low. A major contributor to these rates is the fact that more than 90% of public debt is held by Japanese, mainly institutional, investors. The government and institutional investors obviously have no interest in lower bond prices, and this oligopoly of players can thus sustain the current price level of Japanese government bonds for the time being. However, should national savings fall short of domestic needs – a foreseeable development given the aging Japanese population – future government deficits may be difficult to absorb domestically. In this case, government bond prices could fall and interest rates could rise quickly, which would create extremely serious problems for the Japanese government budget and the country's financial sector. As the central bank already holds some 40% of government debt, it seems that decision makers are at least implicitly swinging toward a policy of debt monetization, an uncharted and highly perilous strategy.

In addition to such structural longer-term concerns, the unprecedented and continuing presence of the central bank in the financial market can lead to short-term liquidity shortages with regard to the availability of Japanese government bonds (JGBs). This can lead to considerable short-term swings in JGB prices and may ultimately trigger significant concerns regarding the stability of the financial system.

Given the record levels of indebtedness in global comparison, along with the recent rise in U.S.-dollar interest rates, Japan's fiscal sustainability looks extremely fragile.

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