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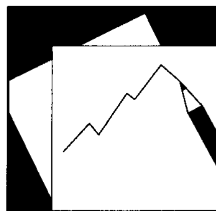

IMF Working Paper

A Status Update on Fiscal Exit Strategies

Fabian Bornhorst, Nina Budina, Giovanni Callegari, Asmaa ElGanainy, Raquel Gomez Sirera, Andrea Lemgruber, Andrea Schaechter, Joong Beom Shin

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Fiscal Affairs Department

A Status Update on Fiscal Exit Strategies

Prepared by Fabian Bornhorst, Nina Budina, Giovanni Callegari, Asmaa ElGanainy, Raquel Gomez Sirera, Andrea Lemgruber, Andrea Schaechter, Joong Beom Shin[1]

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Abstract

With a modest recovery in the global economy underway, and amid rising concerns about the sharp increase in government debt in several countries, debate has increasingly focused on the need to identify and implement fiscal exit strategies. This paper reviews the medium-term plans of 25 countries—the G20 plus six others with large adjustment needs—and finds that most of them have made reasonable progress in defining these strategies. Nevertheless, strategies fall short in some areas, including committing to long-term debt targets, spelling out adjustment measures in detail, and tackling rising health care costs.

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EXECUTIVE SUMMARY

With a modest recovery in the global economy underway, and amid rising concerns about the sharp increase in government debt in several countries, debate has increasingly focused on the need to identify and implement fiscal exit strategies. A survey of 25 countries—the G20 plus six others with large adjustment needs—finds that most of them have made reasonable progress in defining these strategies. Most countries plan to undertake fiscal consolidation in the coming years, with those who are under acute market pressure front-loading their plans and most others seeking to balance the potentially competing demands of maintaining credibility and supporting the recovery. Overall, plans are intended to be relatively growth friendly—emphasizing spending cuts rather than revenue increases—and many countries have included measures to offset some of the impact of the crisis on vulnerable groups.

Nevertheless, strategies fall short in some areas:

- few countries have explicitly committed to a deficit path that would reduce debt ratios to prudent levels in the medium term;
- few have made serious inroads to tackling rising health care costs, which are a major challenge for nearly all of them;
- with the exception of those that are front-loading their adjustment, most countries have not spelled out the measures underlying their adjustment plans in enough detail;
- no country has undertaken a comprehensive reform of social spending to increase its efficiency;
- in some countries, fiscal institutions need to be strengthened; and
- in several countries, including some of those with the largest adjustment needs, the macroeconomic assumptions underlying adjustment programs are more optimistic than other publicly-available forecasts.

I. INTRODUCTION

1. **The global crisis that began in 2008 has had a marked impact on fiscal balances and debt ratios in most advanced and emerging economies.** With a modest recovery in economic activity underway, and amid rising concerns about the sharp rise in government debt in several countries, debate has increasingly shifted toward the need to identify and implement strategies for a post-crisis world. To be successful, such strategies would need to restore debt ratios over time to levels that do not cast doubts about solvency (and leave room for some flexibility for fiscal policy to respond to negative shocks) while remaining consistent with strong, private-sector led, potential growth.

2. **This paper examines the status of exit strategies in 25 countries**: the G-20, plus those non-G-20 members among the countries with the 10 largest illustrative adjustment needs as identified in the May 2010 *IMF Fiscal Monitor* (Greece, Ireland, Latvia, Lithuania, Spain, and Portugal).[2] The sample, covering a mix of advanced and emerging economies, captures countries where the fiscal deterioration associated with the crisis has been small but the gross debt ratio is nonetheless large (for example, Brazil and Italy), those where fiscal balances have weakened significantly even though the gross debt ratio remains modest (such as Australia), and those (notably, the United States and the United Kingdom) where deficits and debt have ballooned since the onset of the crisis.

3. **The paper takes a broad view of exit strategies**. It examines the macroeconomic assumptions underlying countries�' fiscal plans, revenue and expenditure policies with an immediate impact on budget balances, structural reforms—such as to pension and health spending—that will affect fiscal outcomes only in the medium term, and institutional reforms that address the quality or sustainability of fiscal measures. It relies exclusively on publicly-available data: sources of information include national budgets and statements of medium-term policy intentions, such as EU Stability and Convergence Programs, announced until end-September 2010. Throughout, the emphasis is on governments' policy intentions, and not on assessing the likelihood that policies will ultimately be implemented. Nevertheless, the paper provides information on the pace of implementation of exit strategies to date.

4. **The paper is organized in four main sections.** Section II provides a framework for the analysis, identifying the key characteristics that will be used to assess exit strategies. Section III reviews the strategies themselves, looking at issues like the overall size and phasing of any planned deficit reduction and the level of detail (and conservatism) of the underlying macroeconomic assumptions, the specific revenue and expenditure measures that

[2] See IMF (2010a) for details. The illustrative adjustment need is defined as the improvement in the cyclically-adjusted primary balance over 2011-20 that, if subsequently maintained, would be sufficient to restore the government's gross debt ratio to 60 percent of GDP for advanced economies (net debt target of 80 percent for Japan) or 40 percent of GDP for emerging economies by 2030.

support the planned adjustment, and the role of associated reforms in fiscal institutions. Section IV offers some concluding assessments. An appendix provides specifics on exit strategies for each of the countries covered by the paper.

II. Analytical Framework

5. **Exit strategies will be evaluated here relative to several characteristics that "best practice" strategies should meet, based on earlier Fund staff work.**[3]

- **Objective (size) of adjustment.** Exit strategies should identify an appropriate long-term fiscal policy (public debt) objective. In general, stabilizing debt at elevated post-crisis levels is not appropriate. High debt levels are associated with slower output growth and increased macroeconomic volatility, because they lead to higher interest rates and lower investment, and reduce the scope to respond counter-cyclically to negative shocks.[4] Thus, countries that confront high debt levels as a result of the crisis should target a decline in their debt ratios. Those countries that entered the crisis with elevated debt should target a decline to below pre-crisis levels. Even countries that initiated the crisis with relatively low debt could find it optimal to restore debt ratios to pre-crisis levels to recreate fiscal space. In either case, beyond identifying a long-run fiscal policy objective, exit strategies should also identify a visible medium-term anchor to provide a tangible means of gauging progress toward longer term goals. The recent pledge by most advanced G-20 economies to halve their headline deficits by 2013 is one example of such an anchor.

- **Speed of adjustment.** The appropriate speed of adjustment will differ depending on country circumstances. Some advanced economies facing acute market pressure will need more front-loaded adjustment. Emerging economies that are experiencing a rapid economic recovery, and that risk drawing potentially destabilizing capital inflows from a tightening of monetary policy, may also need to tighten fiscal policy upfront. Many others, however, will need an adjustment path that strikes a middle ground between excessive front-loading—which could undermine the recovery—and excessive back-loading—which would weaken credibility of the commitment to medium-term objectives.

- **Nature of commitment.** Commitments that are legally-binding, for example, by being incorporated in a formal budget, may be more credible than simple statements of intention. Likewise, commitments undertaken as part of a formal multi-year

[3] See IMF (2010a) and Blanchard and Cottarelli (2010).

[4] IMF (2010a) presents evidence on the impact of high public debt on interest rates, investment and growth.

framework may have a greater impact on expectations than would those that are binding only for a single year.

- **Prudence of macroeconomic framework.** The credibility of fiscal projections depends in great part on the realism—ideally, prudence—of the macroeconomic assumptions that underlie them. Growth, interest rate, and exchange rate projections that are more optimistic than those produced by independent forecasters are unlikely to give confidence about fiscal prospects.

- **Level of specificity of policy measures.** If announced exit strategies are to provide reassurance about the course of medium-term fiscal developments, they should be sufficiently detailed. This means that exit strategies should be specific rather than general, for example identifying revenue and expenditure measures to be implemented rather than merely promising increases in revenue or cuts in spending.[5]

- **Safeguarding growth.** As much as possible, adjustment should avoid unnecessary harm to growth objectives because, despite its long-term benefits, fiscal consolidation typically causes short-term contractionary effects. Indeed, IMF (2010e) presents estimates that a 1 percent of GDP fiscal retrenchment leads to a 0.5 percent reduction in real GDP. Overall, the data suggest that expenditure-based adjustments tend to be more durable and less harmful to growth than do revenue-based ones, largely because spending-based adjustments are typically accompanied by more monetary stimulus.[6]

- **Protecting the most vulnerable.** Fiscal consolidation may lead to a combination of a slower economic recovery, high unemployment rates, and cuts in social transfers—which could trigger an increase in inequality. Some growth-enhancing fiscal measures—such as shifting toward higher VAT from more distortionary taxes—may negatively affect equity by their regressive nature, creating a trade-off between growth and equity at the very core of the fiscal consolidation design. Across-the-board transfer cuts may end up affecting programs supporting less privileged groups.

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[5] The need for clarity must be balanced against the risk that announcing policy initiatives well in advance gives time for opposition to mobilize against them. In the current environment, however, the need to ensure policy credibility must trump political expediency when identifying a credible medium-term adjustment plan, while the speed of adjustment will need to consider country-specific circumstances including market pressures.

[6] IMF (2010e) provides new evidence (by studying the last 30 years of fiscal consolidation in advanced economies) that expenditure-based fiscal consolidations tend to be less harmful to growth than revenue-based ones. This largely reflects the fact that expenditure-based adjustments are typically accompanied by more accommodative monetary policy responses than are tax-based ones. This could reflect a belief among central bankers that spending-based consolidations are more sustainable, or concerns by the monetary authorities about the impact of tax increases on the price level. With monetary policy already accommodative in many advanced economies, the scope for further monetary stimulus to offset the impact of fiscal tightening may be limited.

Therefore, a careful design that aims at improving the chances of a more socially sustainable adjustment is needed. For example, transfer cuts should be accompanied by an improvement in the effectiveness of social safety nets, supported by means-testing, updated databases, and efficient monitoring. In countries where tax evasion is high, equity can also be enhanced through measures to reduce it.

- **Medium-term considerations.** Especially in many advanced economies, spending pressures are expected to rise in the medium term, particularly as a result of population aging and rapid growth of health care costs. Indeed, the net present value of future spending increases due to aging is estimated at more than 10 times the fiscal cost of the crisis (Cottarelli and others, 2009). Exit strategies that do not incorporate measures to address these concerns risk that gains from cutting current spending or increasing revenues will be gradually offset by higher pension and health care spending. It is thus important that exit strategies include measures to contain medium-term spending pressures in countries where these are expected to be significant.

- **Reforms in fiscal institutions.** Strong fiscal institutions can both enhance confidence in the medium-term orientation of fiscal policy and ensure that short-term objectives are realized. Where improvements are needed, reforms to these institutions should be part of the exit strategy.[7]

6. **Many of the characteristics enumerated above are qualitative rather than quantitative.** Even where measures are quantitative, there is often no clearly-defined optimum: for example, the ideal degree of front-loading of adjustment is subject to uncertainty, especially while the strength of the recovery remains unsure. Much of the analysis in the subsequent sections will, therefore, be qualitative in nature, with a focus on describing what countries have already done and plan to do in the future, rather than on attempting to rank country strategies by presumed quality.

III. Exit Strategies: How Much, How Fast, and How

A. Size and Speed of Adjustment

7. **Overall, countries have adopted adjustment plans whose size and pacing are consistent with best practices and country circumstances, but the failure of most to target explicitly a long-run decline in debt ratios is worrisome.** Countries where the budgetary effects of the crisis have been limited are generally not targeting sustained medium-term adjustment. Among those countries that are planning to adjust, most are

[7] In addition, non-fiscal structural reforms—such as improvements to the business environment—can play an important role in boosting medium-term potential growth. Such reforms are beyond the scope of this paper.

committing to a relatively gradual adjustment that will address only a portion of the crisis-related deterioration in the fiscal accounts over the next few years, with front-loaders generally limited to those facing acute market pressures. Nearly all have established a medium-term anchor against which to measure progress. In most countries, however, the lack of a clear plan to reduce debt ratios to safer levels over the longer term could contribute to uncertainty about the ultimate objectives of fiscal policy and raise the specter of a sustained period of slow potential growth, high unemployment, and limited scope to respond to future negative shocks.

8. **Only a handful of countries—those who were among the least affected by the crisis—are not targeting medium-term fiscal consolidation.** China and Saudi Arabia have announced a preference for a gradual adjustment over the medium-to-long term. China has not spelled out clear medium-term adjustment plans, while Saudi Arabia has established a medium-term target for expenditure but not the fiscal balance. Adjustment in these two countries is expected to rely to a large degree on the expiration of the sizable stimulus measures and cyclical improvements in the fiscal position, partially offset by continued spending on infrastructure and other development priorities. Argentina, Brazil, and Indonesia are not planning any significant fiscal consolidation, and few if any measures are likely to be needed to achieve their medium-term fiscal objectives. While these countries' decisions not to target adjustment is justifiable when viewed through the narrow prism of addressing the fiscal costs of the recent crisis, a case could nevertheless be made for additional consolidation to address long-standing structural fiscal weaknesses, to create scope for other priority spending, or to reduce debt vulnerabilities that predate the crisis.

9. **Almost all countries have established medium-term deficit targets, but relatively few have identified longer-term, debt-related objectives**. Among the countries with debt targets are India and Portugal which have specified debt goals for 2014/15 and 2012, respectively. Among the advanced G-20 countries, only the United Kingdom targets a reduction in its public sector net debt ratio by 2015/16. Australia's medium-term strategy includes the goal to improve the government's net financial worth over the medium term, but without a specified target and date; however, its gross and net debt are among the lowest in advanced economies. The United States aims to achieve a stable federal debt-to-GDP ratio by 2015, and Japan projects to reduce its debt-to-GDP ratio from 2021/22 on. Most euro area countries and accession candidates are committing to an adjustment in flows: specifically, to achieving an overall deficit not greater than 3 percent of GDP with the country-specific target dates varying from 2012 to 2014/15 (see also Section III.B). While the Maastricht debt criterion of 60 percent of GDP remains in effect in these countries, the meaning of their commitment to make steady progress towards this goal is uncertain in the present environment. As a practical matter, the Maastricht debt criterion has not played a key role in guiding policy-making even in more tranquil periods in the past, but under recent proposals by the European Commission it would receive greater prominence (see Box 6 in IMF, 2010b). Canada, Germany, and Korea are projecting a broadly balanced overall budget in the

medium term (which implicitly would involve a decline in the debt ratio to zero asymptotically), while Lithuania is aiming for a primary surplus.[8] However, the implications of these deficit targets for debt ratios have not been made explicit in country programs.

10. **Most adjustment plans cover a three-year horizon, through 2013**. Lithuania and Turkey‗s plans underlying the analysis in this paper include targets until 2012.[9] For South Africa, current plans cover the 2012/13 fiscal year. It would appear that the period of coverage is largely dictated by procedural considerations, as in most cases it coincides with the requirements of domestic budgetary frameworks. In a few cases where adjustment plans exceed the period required under domestic rules, the coverage period is dictated by international commitments.

11. **As might be expected, planned adjustment efforts are generally largest in those countries where market pressures are greatest** (Figure 1). Greece, Ireland, Portugal, and Spain are among the largest adjustors. The United Kingdom—where the absence of clear market pressures could be due to the large share of net debt issuance purchased by the Bank of England—also plans a relatively large fiscal adjustment.[10] Figure 1 details the consolidation plans for the 20 countries that have specified fiscal consolidation targets, for all years where information is available (up to 2015). The consolidation is expressed in changes in the overall balance, primary balance, and where available, cyclically adjusted balance.

12. **The planned pace of adjustment is significantly slower than the pace of deterioration during the crisis.** On average, countries project an improvement in their headline fiscal balances of about 4 percentage points of GDP during 2010-13, which represents a little more than half of the deterioration witnessed during the crisis (2007-09) (Table 1).[11] About one-third of the planned adjustment is projected to occur in each of the next two years (Figure 2). The overall pace of adjustment—about 1 percent of GDP annually in cyclically-adjusted terms—is broadly consistent with maintaining a balance between reducing deficits and avoiding an abrupt fiscal tightening that could undermine the recovery.

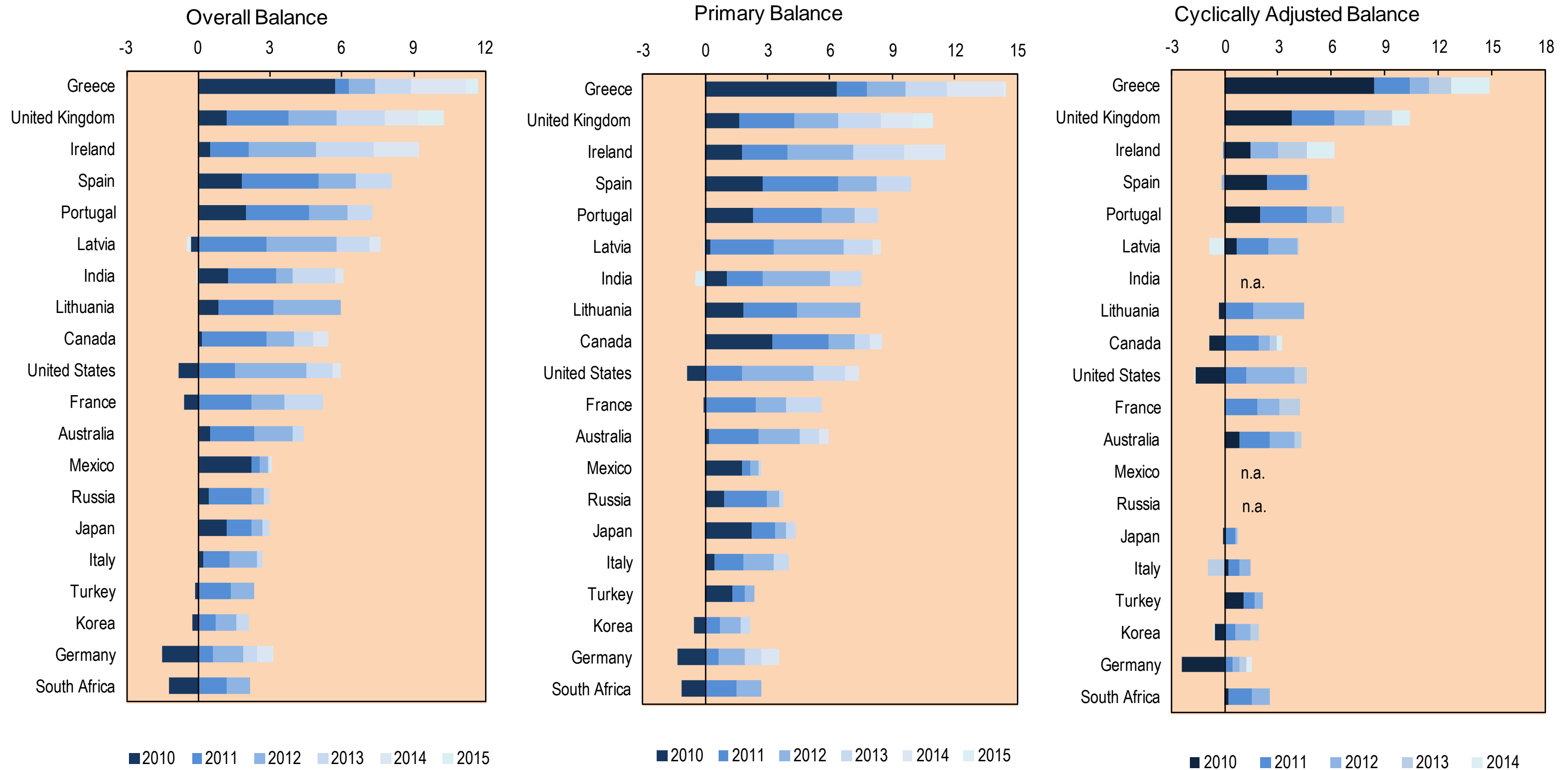
[8] Germany‗s constitutional fiscal rule limits the structural Federal deficit to 0.35 percent of GDP starting in 2016 and to zero for the German *Länder* from 2020.

[9] In mid-October Turkey announced a new three-year Medium Term Program. Since these updated projections are not reflected in the WEO database, their implications for fiscal projections are therefore not taken into account in this paper.

[10] See IMF (2010b.)

[11] For Japan, this does not include the stimulus package approved by the cabinet on October 8, which would amount to about 1 percent of GDP. For the United States, the data do not include the effect of the new stimulus package announced by the U.S. administration in mid-September. If all components of such a package were approved and implemented with delay, there would be almost no change in the fiscal deficit of the United States in 2011, with respect to the previous year.

Figure 1. Adjustment Plans for the Overall Balance, Primary Balance, and Cyclically Adjusted Balance, 2010-15
(Planned annual change, percent of GDP)



Source: IMF staff calculations based on authorities' plans.
For Ireland and the United States, adjusted to exclude financial sector support recorded above the line. For the United States, data for federal government in calendar years. For Russia, data for the federal government. For the United Kingdom data for fiscal years. Cyclically adjusted balance based on authorities' information where available. Where unavailable, based on cyclical adjustment using standard elasticities and the output gap. Output gap as estimated by authorities, or projections of the output gap based on WEO 2009 output gaps and authorities' projections for real GDP and potential GDP growth from 2010 (see also Box 1).

13. **While most of the countries covered here are opting for a frontloaded adjustment the three largest economies are envisaging a more gradual approach.**[12] Greece, Ireland, Portugal, and Spain have all frontloaded their adjustments, after coming under acute market pressure. The United Kingdom, where the absence of market pressures may reflect large debt purchases by the Bank of England, is also frontloading. In the United States, where the economic recovery remains uncertain and financing pressures are absent, the backloaded adjustment plan will continue to support economic activity and provide a counterweight to the impact of more frontloaded retrenchment elsewhere. The small adjustment projected for 2011 for Japan aims to balance the desire to support already-sluggish growth and the need to restore fiscal sustainability; however, to achieve the debt-stabilizing target by 2021/22 significantly more adjustment than currently announced will be needed. In Germany, the significant fiscal impulse from 2010 will be gradually withdrawn, beginning in 2011.

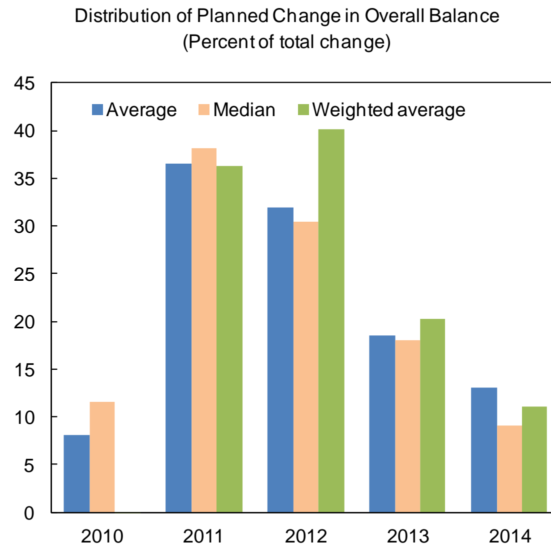
Table 1. Fiscal Indicators of Crisis Impact and Planned Adjustment, 2007-13
(Percent of GDP)

	Authorities		Crisis impact (Change)	Adjustment plan (Change)	Plan in percent of crisis impact
	2010	2013 [1]	2007-09	2010-13 [1]	
Overall balance[2]					
Simple average	-6.9	-2.8	-7.2	4.0	56
Median	-7.6	-3.0	-7.1	4.2	59
Weighted average	-7.8	-3.6	-8.9	4.2	47
Public debt[3]					
Simple average	68.5	73.4	14.9	4.7	32
Median	70.5	75.7	13.6	3.2	24
Weighted average	75.6	82.0	14.7	5.9	40
Cyclically adjusted balance[2, 4]					
Simple average	-5.4	-2.4	-4.6	3.0	64
Median	-5.8	-2.0	-3.4	3.0	88
Weighted average	-5.4	-2.6	-5.1	2.7	53

Source: IMF staff calculations based on authorities' plans, for 20 adjusting countries and October 2010 WEO.
[1] 2012 projection for overall balance used for Lithuania, South Africa and Turkey. 2011 debt projection for India.
[2] For Ireland, the fiscal balances do not include the most recent issuance of promissory notes to recapitalize banks.
[3] General government gross debt; for Japan's data by the authorities: gross debt of central and local governments.
[4] Not available for all countries and all years; for calculations of the authorities' CAB, see footnote in Figure 1.

[12] Frontloaded (backloaded) is defined here as a higher (lower) improvement under the authorities' plans in the overall balance in 2011 (or 2010, where the adjustment started earlier) than on average for each of the subsequent years of the planning horizon. Evenly adjustment is defined as a broadly evenly improvement in the overall balance for each year of the planning horizon.

Figure 2. Crisis Impact, Size, and Timing of Adjustment, 2007-13



Source: IMF staff calculations based on authorities' plans, for 20 adjusting countries and October 2010 WEO.
Notes: Outer years include fewer countries.

14. **Although economic recovery is expected to contribute to improved headline fiscal positions, the bulk of the planned adjustment is structural.** Figure 3 compares planned adjustment in the overall balance between 2010-13 with that in the primary balance and the cyclically adjusted primary balance. For most countries interest bills are projected to rise, in some cases significantly, as indicated by the distance of the red markers from the 45 degree line. The projected cyclical component of the recovery is indicated by the distance between the red and the blue marker. On average, 68 percent of the improvement in primary balances is projected to be structural (71 percent when using the median, and 47 percent when using a weighted average). For some countries (e.g., Greece) the adjustment in cyclically adjusted terms is higher than the change in the primary or overall balance over the period, reflecting persistent and large output gaps, and sharply increased interest expenditure.

15. **While the structural adjustment is large, it represents, on average, less than half of the adjustment need identified in the May 2010 *IMF Fiscal Monitor*** (Figure 4). Compared with an adjustment scenario in which by 2030 advanced economies would reach a debt-to GDP ratio of 60 percent[13] and emerging economy debt ratios converge to 40 percent, the plans spelled out until 2013 cover, on average, only around 45 percent of the weighted adjustment need. The withdrawal of fiscal stimulus in these countries in 2011—around

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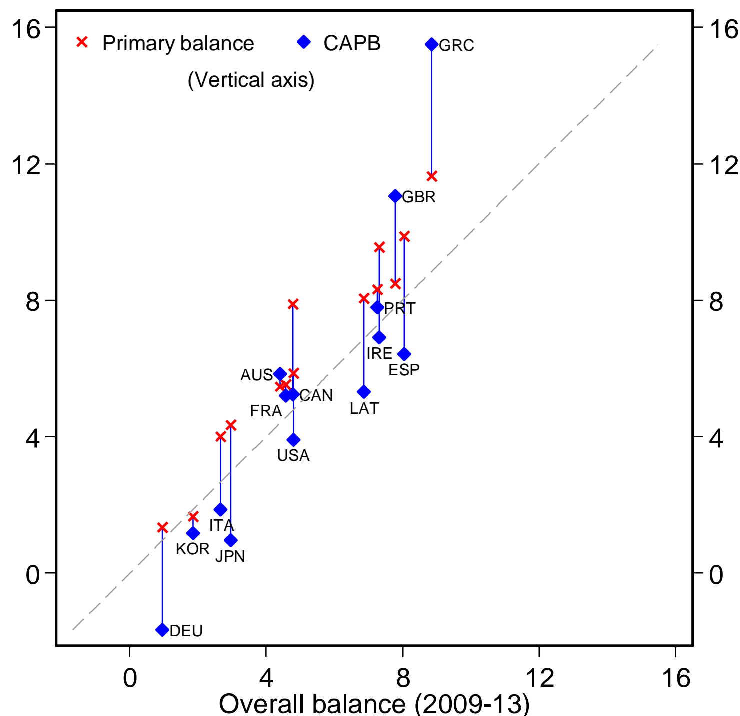
[13] Net target of 80 percent of GDP for Japan. These are illustrative debt targets that coincide broadly with the average pre-crisis debt ratios. Country authorities, of course, may find other targets more appropriate. See Appendix Tables 1 and 2 in the November 2010 *Fiscal Monitor* (IMF 2010b) for the latest estimates.

1 percent of weighted GDP—accounts for one third of this adjustment. While the adjustment scenario in the *Monitor* is illustrative, it implies that significant further adjustment would be needed over 2014-20—slightly below the average annual pace planned over 2010-13—to restore debt ratios to the above-reported levels by the end of the next decade. Of course, as noted above, to date no country has established an explicit long-run policy objective of reducing debt ratios to pre-crisis levels.

16. **Indeed, with few exceptions, planned adjustments will not prevent further increases in debt over the next few years, although the rate of debt accumulation should slow in most cases.** With the exception of Canada, India, Korea, Mexico and Turkey, where debt levels at the end of the forecast horizon are projected to be lower than in 2010, none of the countries that are adjusting project their debt ratios to be on a downward path by 2013. Between end-2010 and end-2013, countries will add, on average, 4.7 percent of GDP (or one third of the 2007-09 debt increase) to existing debt levels.[14]

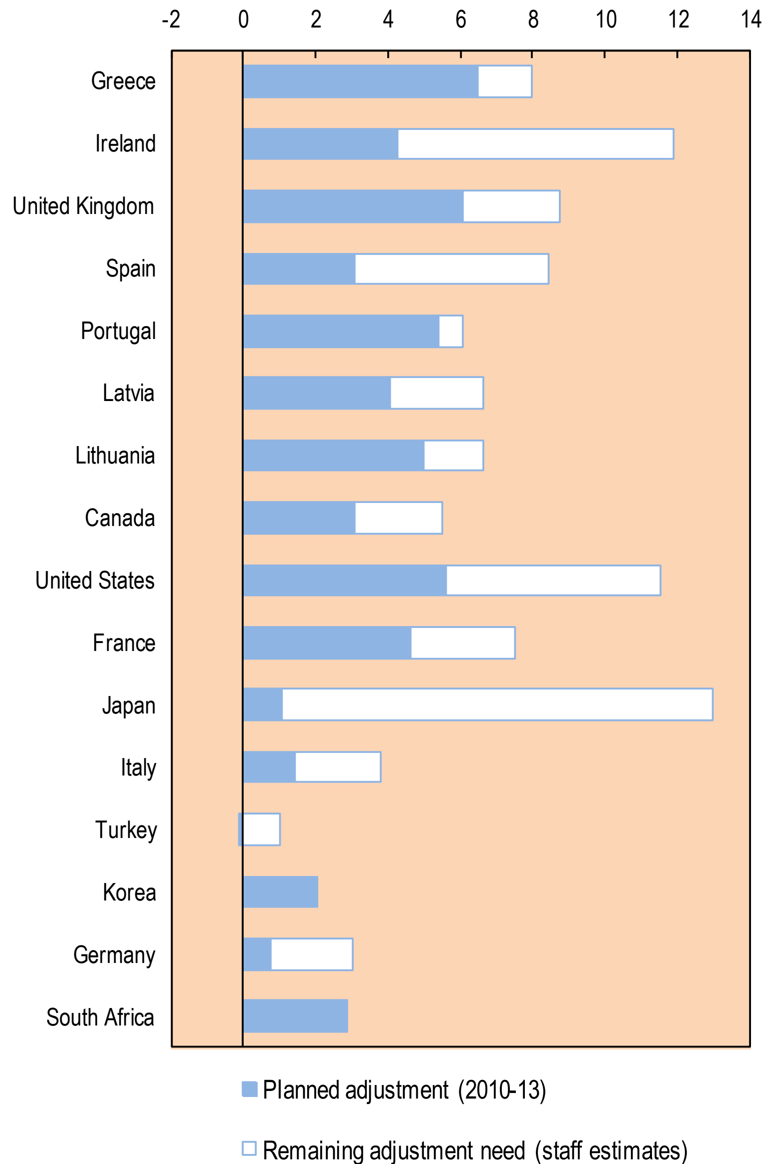
Figure 3. Adjustment in the Overall Balance, Primary Balance, and Cyclically Adjusted Primary Balance, 2009-13
(Percent of GDP)



Source: IMF staff calculations based on authorities' plans. See note to Figure 1 for details on the calculation of the cyclically adjusted primary balance.

[14]The projected debt increase during 2010-2013 is 5.9 percent of GDP on weighted average terms.

Figure 4. Planned Structural Adjustment (2010-13) and Remaining Adjustment Need until 2020
(Percent of GDP)



Source: IMF staff calculations based on authorities' plans and October 2010 WEO.
Note: The figure compares the estimated adjustment needs between 2010-20 to achieve debt targets in 2030 (in general, 60 percent of GDP in advanced economies (net debt target of 80 percent of GDP for Japan) and 40 percent in emerging economies and the authorities' planned change in the cyclically adjusted primary balance (CAPB) between 2010-13. For the United States, the planned adjustment refers to the federal government only, while the adjustment need is expressed for the general government. Where the remaining adjustment need is negative, this is shown as zero in the figure (i.e., the planned adjustment until 2013 would be sufficient to fully meet the adjustment need to achieve the debt target).

Box 1. Data Constraints for Analyzing the Authorities' Adjustment Plans

All plans analyzed in this section contain medium-term objectives formulated in terms of overall balance and public debt ratios. The United States has also announced a primary balance objective while Germany and the United Kingdom have also formulated plans in structural terms. In the case of Germany, the structural budget balance rule requires the 2016 federal structural deficit no higher than 0.35 percent of GDP and the adjustment to take place from 2011 in broadly equal steps. The United Kingdom is planning to balance the cyclically adjusted current budget by 2015/16.

To derive primary balance and cyclically-adjusted (primary) balance targets from the authorities' headline objectives some assumptions had to be made. For several countries, net interest payments were taken from WEO projections. Data gaps were significant for calculating the CAB and CAPB. In those cases, CABs and CAPBs were estimated using standard elasticities and the output gap. Output gaps are either those published by authorities or were derived by using the 2009 WEO estimates for the output gap and applying the authorities' projections of growth and potential growth to this basis. The biggest caveat in this procedure is that the authorities' views may diverge from those in the WEO for potential output in 2009.

Many countries are in the process of revising their adjustment plans and underlying macroeconomic projections. With budget preparations underway in many countries, key macroeconomic variables are being reassessed by the authorities. This may affect overall budget and debt plans. Moreover, it would affect the CAB and CAPB estimates. The analysis in this section relies on those fiscal and macroeconomic projections that have been conveyed publicly by the authorities. However, this may in some cases imply that (some) fiscal indicators are from a more recent ―vintage" than macroeconomic indicators or vice versa.

Several other data-specificities need to be pointed out. Averages across countries reported herein are typically simple rather than weighted averages, as the focus is on identifying differences in policy approaches across countries rather than on measuring the global impact of policies. When referring to the authorities' plans until 2013, the information relies on 2010-13 comparisons for all countries except for Lithuania, South Africa, and Turkey, where the horizon is 2010-12, and for debt levels data for India which are available only until 2011. The fiscal data for Australia and the United Kingdom are on a fiscal year, not a calendar year, basis. For the United States and Japan, data have been converted to calendar years. For Japan, the authorities report gross debt for central and local governments. Coverage of the data is for the general government, except for the United States and Russia (federal government) and Korea (central government). Ireland and the United States report some financial sector support measures above the line as expenditure. In an effort to ensure cross-country comparability the aggregates for these countries were adjusted accordingly.

The analysis on the composition of adjustment is based on the number of measures planned by authorities rather than the budgetary impact of those measures. Many authorities have not yet specified and quantified the size and impact of policy measures that they intend to adopt. Therefore, the analysis in Section III.E) rests on the type and number of measures announced in adjustment plans (e.g., public wage cuts, VAT rate increases etc.) This, however, does not allow one to analyze their relative quantitative importance.

B. Nature of Commitment

17. **While there is some variation across countries in the nature of the commitment to consolidation, the choice seems to be guided by procedural and legal rather than strategic issues.** At the national level, half of the countries that have announced adjustment plans have included their medium-term targets in the annual budget; another six countries have used medium-term fiscal frameworks or some other type of government strategy document (Table 2).[15] Four countries (Australia, Canada, Korea and Spain) have announced their plans in both. In most cases, the medium-term plans are rolling frameworks, typically with three-year horizons, to which a new year is added each year and the remaining years can be revised. While this provides some medium-term planning horizon and greater transparency for the public to assess policy revisions, such frameworks are not necessarily binding. Thus, they leave ample room to flexibly adjust plans, including in response to unforeseen economic developments. Transparency is critical to provide confidence that any revisions are prompted by macroeconomic shocks and not political expediency. For the most part, the form of commitment reflects legal or bureaucratic obligations spelled out in national codes. For this reason, greater use of effective national fiscal rules could provide additional support in countries where fiscal institutions are weaker, helping to tilt the trade-off between flexibility and credibility back toward the latter[16] (see Section III.G).

18. **The majority of countries have also committed internationally to fiscal adjustment, providing some international coordination and peer pressure.** The Greek and Latvian adjustment plans are supported by EU/IMF financing. All EU member states have laid out adjustment plans in their Stability and Convergence Programs, and all EU-countries analyzed here are under the Excessive Deficit Procedure with country-specific requirements on the size and speed of adjustment of bringing overall balances back to the 3 percent of GDP Maastricht criterion by 2013 for most countries, but in some cases by 2012 (Latvia, Lithuania, and Italy) or by 2014 (Ireland, Greece, and the United Kingdom; fiscal year 2014/15 for the latter). And finally, the advanced G-20 countries (excluding Japan) have committed to halve their headline deficits by 2013 and stabilize or reduce their debt ratios by 2016 under the Toronto declaration of June 26-27, 2010. On average, however, this commitment is less ambitious than what countries have already committed to domestically, making it symbolic rather than binding.

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[15] For emerging countries (India, Korea, Russia, South Africa and Turkey), the medium-term budget framework is a rolling three-year budget.

[16] The design of fiscal rules can also enhance flexibility. In particular, cyclically adjusted balance rules and expenditure ceilings have strong economic stabilization properties. Escape clause can be defined to deal with exceptional circumstances (see IMF, 2010d)

Table 2. Nature of Commitment to Fiscal Adjustment

Natur of Commitment	Number of countries	Countries
National Commitment		
Budget	10	Australia, Canada, Ireland, Korea, Mexico, Portugal, South Africa, Spain, United Kingdom, and United States
Medium-term fiscal framework/ strategy/ plan	10	Australia, Canada, Germany, India, Italy, Japan, Korea, Russia, Spain, and Turkey
International Commitment		
Programs (IMF/EC)	2	Greece and Latvia
Stability and Growth Pact	10	France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Portugal, Spain, and United Kingdom
Toronto declaration	9	Australia, Canada, France, Germany, Italy, Japan[1], Korea, United Kingdom, and United States
Total number of countries with at least one commitment	20	
Total number of countries with more than one commitment	14	Australia, Canada, France, Germany, Greece, Latvia, Ireland, Italy, Japan[1], Korea, Portugal, Spain, United Kingdom, and United States

Source: Based on country authorities' information.
[1] While under the Toronto declaration Japan has not committed to the same deficit and debt targets as the other advanced G-20 economies, its Fiscal Management Strategy is regarded as an international commitment as the Strategy is quoted in the Toronto declaration, acknowledging the specific circumstances of Japan.

C. Assessment of Macroeconomic Frameworks

19. **There appears to be scope for more prudent macroeconomic assumptions in some countries' adjustment programs.** In several cases, particularly in advanced economies with large adjustment needs, growth assumptions underlying national programs are more optimistic than those in the WEO or the Consensus Forecast. Adjustment programs built on macroeconomic assumptions that are significantly more benign than other publicly-available forecasts could be seen as less credible, with potential negative feedback loops to interest rates that would make adjustment even more costly. Some data gaps should also be filled in.

20. **The provision of medium-term macroeconomic projections is generally satisfactory, but significant gaps persist.**[17] Only France, Spain, and the United Kingdom have so far provided a complete set of key macroeconomic indicators (real, nominal and potential GDP, interest rates and output gaps) for 2010-13 (Table 3). Data provision in EU countries is relatively good, perhaps reflecting requirements for their Stability and

[17] This section includes official data releases through late September 2010 in connection with fiscal plans. The countries involved in budget preparation will likely release revised macroeconomic projections in the coming weeks. However, it is still useful to analyze the content and comprehensiveness of intra-year macro data releases, because of the impact on expectations.

Convergence Programs. Data availability is also good in those countries where fiscal agencies play a role in developing macroeconomic projections and/or monitoring fiscal policy. With few exceptions, a significant shortfall persists in the provision of interest rate and output gap data, which are provided by only 8 out of 25 countries in the sample. A wider diffusion of output gap data is crucial for the assessment and evaluation of cyclically-adjusted balances.[18] In the absence of complete output gap data, the analysis here looks at underlying developments by comparing projected output growth to assumed growth of potential GDP.

Table 3. Availability of Macroeconomic Projections, 2010-13

Country	Real GDP growth	Nominal GDP growth	Potential GDP growth	Interest rates	Output Gap
Argentina	Good	Good	None	None	None
Australia	Good	Good	Good	Good	None
Brazil	Good	Good	Good	Good	None
Canada*	Good	Good	Good	Good	None
China	Good	Good	Good	None	Good
France	Good	Good	Good	Good	Good
Germany*	Good	Good	Good	Good	None
Greece	Good	Good	Good	None	Good
India	Good	Good	None	None	None
Indonesia	Good	Good	Good	Good	None
Ireland	Good	Good	Good	None	None
Italy	Good	Good	Good	Good	Partial
Japan*	Good	Good	Good	Good	None
Korea*	Good	Good	Good	Good	None
Latvia	Good	Good	Good	None	Good
Lithuania	Partial	Partial	Partial	Partial	Partial
Mexico*	Good	Good	None	Good	None
Portugal	Good	Good	Good	Good	None
Russia	Good	Partial	None	Good	None
Saudi Arabia	Good	Good	Good	Good	None
South Africa	Good	Good	Good	Good	None
Spain	Good	Good	Good	Good	Good
Turkey	Partial	Partial	Partial	Partial	Partial
United Kingdom*	Good	Good	Good	Good	Good
United States*	Good	Good	Good	Good	None

Data availability: None / Partial / Good

Source: IMF staff estimates based on country authorities' data.
Notes: "Good" denotes that the available macro data cover at least the 2010-13 period; "Partial" indicates that data have been provided, but not until 2013; "None" indicates that either no or less than two years of data have been provided. A " * " denotes the countries with a fiscal agency.

[18] Many countries provide only potential and real output growth but they do not provide the levels, which are essential for the calculation of the output gaps. The calculation of the output gap using pre-crisis WEO data on real and potential GDP levels combined with the real and potential GDP data provide by the authorities often generates implausible projections, showing persistent (and in some cases growing) output gaps.

21. **Authorities' projections tend to be more optimistic than other publicly-available forecasts, especially in some advanced economies.** For 2011, the authorities' real GDP growth forecasts exceed the Consensus Forecast for most of the advanced economies, with the gap being particularly large for Ireland (1 percentage point) and the United States (0.8 percentage point) (Table 4). Over the period 2010-13 the discrepancy relative to WEO forecasts is somewhat smaller on average, but even bigger in some individual countries with Ireland and United States again showing the biggest discrepancy (1.5 and 1.2 percentage point, respectively). Of the eight advanced economies with the largest illustrative adjustment needs, only Japan and Greece have official forecasts that do not significantly exceed the WEO forecasts.[19] To some extent, this may reflect differences of views between the authorities and Fund staff about the likely impact of fiscal consolidation on growth and the prospects for expansionary fiscal adjustment as well as the impact of structural reforms that the authorities envisage but which have not yet been adopted. It presumably also reflects in large part the differing assumptions about the impact of the crisis on potential growth (Figure 5). For emerging markets real GDP growth through 2013 are broadly in line or in some cases even more conservative than Consensus and WEO projections. Differences are noteworthy, however, for Argentina, Brazil and Turkey.

22. **Interest rate projections are generally in line with the WEO in advanced economies but are lower in emerging economies** (Figure 6). For advanced economies, the differential is largely limited to 2010, but for emerging markets it persists throughout the period. The underestimation of interest rates could substantially weaken the fiscal position of emerging markets, making them less resilient to adverse shocks.

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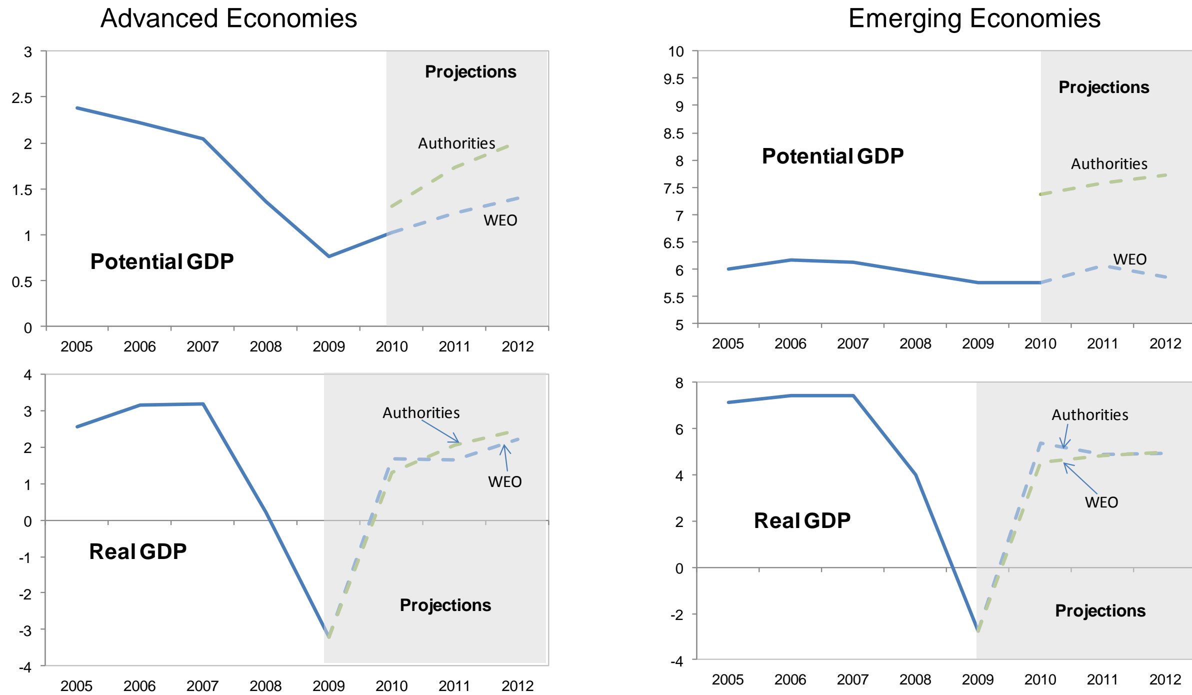
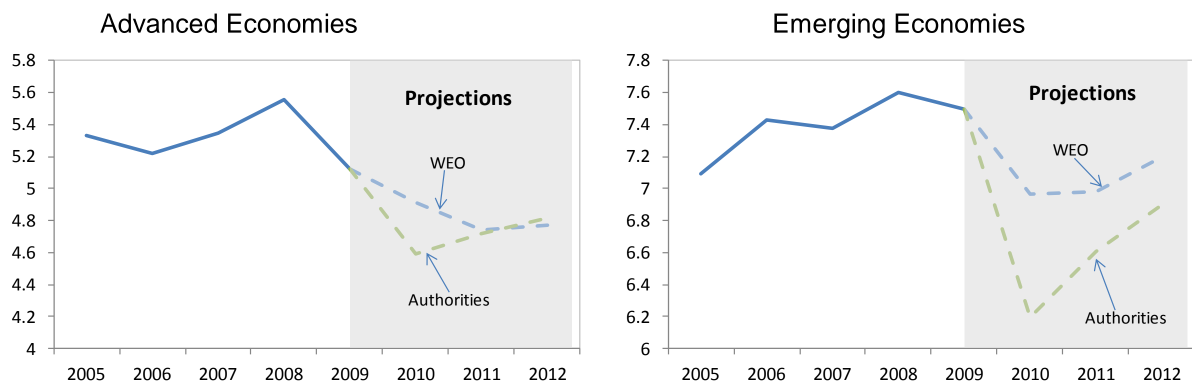
[19] The group comprises France, Greece, Ireland, Japan, Portugal, Spain, the U.K. and the U.S.

Figure 5. Potential and Real GDP: Authorities' and IMF Staff Projections
(Percent change)



Source: Country authorities' data and October 2010 WEO.
Note: 2009 data always refer to WEO except for potential GDP data. IMF staff projections are those in the October 2010 WEO.

Figure 6. Implied Interest Rates: Authorities' and IMF Staff Projections
(Percent change)



Source: Country authorities' data and October 2010 WEO.
The implied interest rate is calculated as the ratio of the interest payments with the previous year debt. 2009 data always refer to WEO.

Table 4. Real GDP Growth Forecasts by the Authorities, IMF Staff and Consensus, 2011-13
(Percent)

	2011		2011-13	
	Authorities	Consensus	Authorities	WEO
	(Annual percent growth)		*(Annual average percent growth)*	
Argentina	3.6	4.1	3.9	3.3
Australia	3.8	3.4	3.4	3.4
Brazil	5.5	4.4	5.5	4.1
Canada	3.2	2.7	3.0	2.6
China	9.6	9.0	9.5	9.5
France[1]	2.0	1.5	2.3	1.8
Germany	1.6	1.7	1.7	2.0
Greece	-4.0	-2.3	-1.9	0.2
India	8.4	8.4	8.3	8.2
Indonesia	5.9	6.1	6.3	6.5
Ireland	3.3	2.3	4.0	2.5
Italy[1]	1.2	1.1	1.5	1.2
Japan	2.1	1.5	1.9	1.8
Korea	5.0	4.3	5.0	4.3
Latvia	3.3	3.3	3.8	3.8
Lithuania[2]	2.8	3.0	2.0	2.8
Mexico	3.8	3.7	4.1	4.5
Portugal	0.5	0.2	1.1	0.5
Russia	3.4	4.5	3.7	4.3
Saudi Arabia	4.6	5.1	4.8	4.5
South Africa	3.2	3.8	3.6	3.9
Spain	1.3	0.6	2.2	1.5
Turkey[2]	3.7	4.3	4.2	3.6
United Kingdom	2.3	2.0	2.6	2.2
United States	3.6	2.8	4.0	2.8
All countries	3.3	3.3	3.6	3.4
Advanced	2.0	1.7	2.4	2.1
Emerging	4.8	5.0	5.0	4.9
Countries with adjustment needs	2.7	2.6	3.0	2.9

Source: Country authorities' information, Consensus forecasts (August 16, 2010 survey), October 2010 WEO, and IMF staff calculations.

[1] Refers to the draft budget from September 29, 2010 (France) and the "Documento di Finanza Pubblica" from September 30, 2010 (Italy). These updated projections are not reflected in the WEO database and their implications for fiscal projections are therefore not taken into account in this paper.

[2] Limited to 2011 and 2012 because of lack of authorities' data for 2013 real GDP growth.

D. Level of Specificity of Policy Measures

23. **In most countries, many adjustment measures have not yet been enacted or even specified concretely.** Of the countries analyzed here, only half have adjustment plans with some detailed information on proposed measures for the initial years (Table 5). Even in these countries, most measures have not been enacted, and few have been accompanied by estimates of their projected fiscal impact. Instead, plans at this stage tend to be a list of proposals for which it is difficult to assess either their relative importance or the likelihood that they will be implemented. The exceptions to this rule are the several countries that have frontloaded their adjustment—where measures have already begun being implemented—and some countries with detailed medium-term frameworks (e.g., Canada and Germany). As budgets for 2011 are being prepared across countries, greater clarity should emerge regarding measures for the next year. However, more needs to be done to underpin medium-term adjustment plans with concrete and sustained policies.

Table 5. Level of Specificity of Adjustment Plans on Type of Measures and Over Time

	Number of countries	Countries
Detailed Measures		
On the expenditure side	10	Canada, France, Germany, Greece, Italy, Latvia, Portugal, Spain, United Kingdom, and United States
On the revenue side	10	Canada, France, Germany, Greece, Latvia, Portugal, Spain, Russia, United Kingdom, and United States
Broad areas of adjustment identified but no detailed measures	9	Australia, India, Ireland, Japan, Korea, Lithuania, Mexico, South Africa, and Turkey
Detailed Measures Over Time		
Detailed in earlier years	10	France, Germany, Ireland, Italy, Japan, Korea, Lithuania, Russia, United Kingdom, and United States
Detailed across all years	5	Canada, Greece, Latvia, Portugal, and Spain
No detailed measures	5	Australia, India, Mexico, South Africa, and Turkey

Source: Based on country authorities' information.

24. **As might be expected, the level of detail in adjustment programs declines as the horizon moves farther into the future.** For example, Germany's 2011-14 medium-term budgetary plan includes estimated annual savings from planned measures, but an "unspecified adjustment amount" remains in 2014. In addition, the plan incorporates efficiency gains that are difficult to quantify, and many of the measures still need to be legislated. France has spelled out only its broad plans and measures until 2013 in its Stability Program, and some other advanced economies with large adjustment needs, such as Japan,

have not yet provided significant detail on the specific adjustment measures to be implemented. The United States has broadly identified adjustment measures, but about 1 percent of GDP worth of measures is yet to be spelled out, with Congressional approval still to come. In most emerging economies, with the exception of Latvia and Russia, adjustment plans lack specificity, reflecting in part lower pressures to adjust and a greater reliance of plans on expected revenue gains through higher economic growth and better compliance (see Section III.E). For some emerging economies, including India, Mexico, South Africa, and Turkey, the distribution of adjustment over time is yet to be spelled out. In other cases, particularly for countries that face market pressure (Portugal and Spain), and countries supported by EU / IMF financing (Greece and Latvia) measures have been specified across all years of the adjustment plan.

E. Safeguarding Growth[20]

25. **The ongoing fiscal consolidation seems to be appropriately taking growth concerns into consideration, with expenditure measures significantly outnumbering revenue measures in most countries** (Table 6).[21] Medium and high deficit countries have relied on plans largely based on expenditure measures or a roughly even mix of revenue and expenditure measures (Figure 7). In particular, Canada, Korea, Latvia, and Lithuania have announced fiscal adjustments almost entirely based on expenditure measures. Other countries, especially those with frontloaded adjustments (Portugal, Spain, and the United Kingdom), have incorporated robust revenue measures in their programs, such as VAT rate increases, although their overall plans still rely largely on expenditure measures. On the other hand, where tax increases do play a significant part in adjustment plans, this has tended to be in two situations: countries where adjustment needs are large and revenue ratios are relatively low (Greece and the United States), or in emerging market countries that have large investment needs (India, China) or that are seeking to diversify revenue sources (Mexico). Going forward, the consolidation should be seen as an opportunity to revamp government policies and operations. Improving expenditure efficiency,[22] rationalizing and streamlining the public service, raising public labor productivity, and designing more efficient tax systems are important medium-term objectives that should be supported by the consolidation measures.

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[20] This section covers all 22 countries that envisage some fiscal consolidation over the medium term. Therefore, even those countries that have not spelled out a specific consolidation plan are covered, in order to present a broader review of revenue and expenditure measures being adopted.

[21] This classification is based on the number and type of measures announced. As noted, lack of information on the budgetary impact of those measures prevents an analysis in terms of the relative importance of those measures.

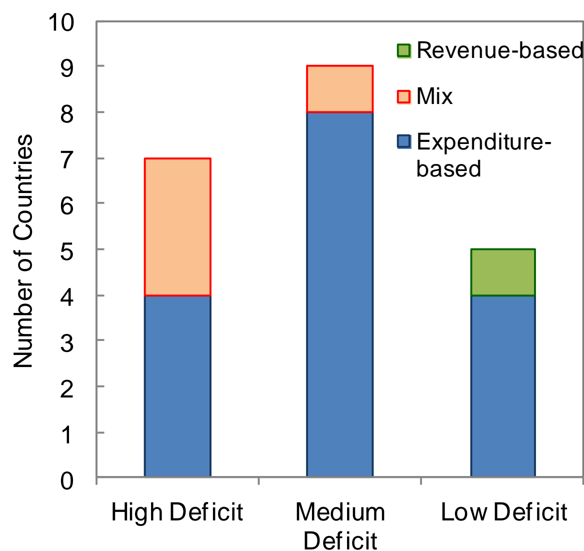
[22] For example, Canada has announced the review of government operations to identify the five percent lowest-priority and lowest-performing programs.

Table 6. Planned Composition of Fiscal Adjustment

Deficit (2009)	Largely Expenditure-based	Mix (broadly equally-based)	Largely Revenue-based
High deficit (above 10% of GDP)	Ireland	Greece	
	Japan	India	
	Spain	United States	
	United Kingdom		
Medium deficit (between 5 and 10% of GDP)	Portugal	Russia	
	Canada		
	France		
	Italy		
	Latvia		
	Lithuania		
	South Africa		
	Turkey		
Low deficit (below 5% of GDP)	Australia	Mexico	China
	Germany		
	Korea		
	Saudi Arabia		

Sources: IMF staff estimates based on country authorities' information.
Note: Categorization is based on the whole adjustment period based on authorities' announced plans (including 2010 where applicable). Largely expenditure (revenue)-based reflects that adjustments rely on expenditure (revenue) measures in cumulative terms of more than 60 percent of total adjustment. "Broadly mixed" reflects expenditure/revenue measures of about 40-60 percent. In individual years the composition may be different (e.g., Germany, Portugal and Turkey have a mixed-adjustment in the first years, while relying more on expenditure in the outer years).

Figure 7. Composition of Adjustment by Size of Initial Deficit



Sources: IMF staff estimates based on country authorities' information.
Note: High deficit countries are those with an overall deficit of more than 10 percent of GDP in 2009; medium deficit countries are those with a deficit between 5 and 10 percent of GDP; and low deficit below 5 percent of GDP.

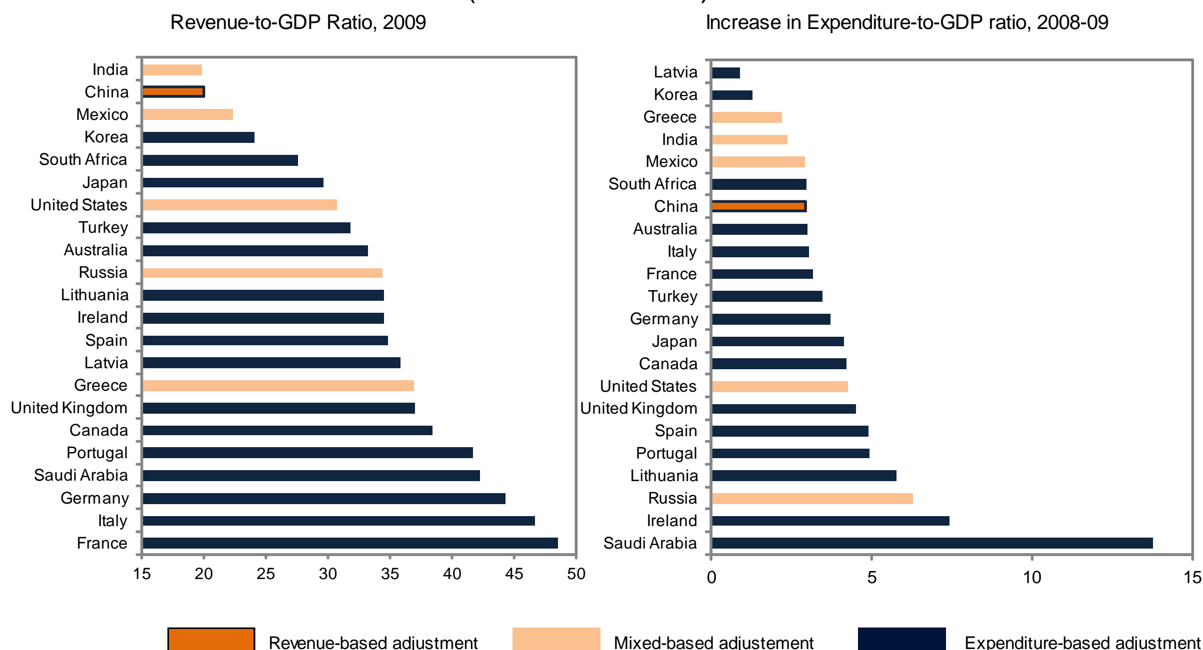
26. **Most countries relying on expenditure cuts face a sizeable adjustment, have high tax-to-GDP ratios, and experienced large spending increases during the crisis** (Table 7). The focus on expenditure-based adjustment, therefore, represents a combination of the unwinding of automatic or discretionary spending increases associated with the crisis, as well as a strategic choice to avoid the distortions that could accompany a further increase in already-high tax ratios.[23] Indeed, in advanced economies fiscal stimulus unwinding represents around 80 percent of the total expenditure reduction in 2011 (total expenditures are projected by the authorities to fall by 1.1 percentage point of GDP between 2010 and 2011). This is an adequate response to the large spending increases that materialized between 2008 and 2009—above 5 percentage points of GDP for some countries (Figure 8). Countries with the

[23] Nevertheless, even though avoiding further tax increases in high tax-to-GDP jurisdictions is recommendable for growth consideration, there may be cases where low hanging fruits should be explored, such as generous tax exemptions and large compliance gaps. Addressing these issues can support healthy consolidations by building more efficient and equitable tax systems.

highest revenue-to-GDP ratios are overwhelmingly opting to base their adjustment primarily on expenditure cuts (Figure 8). Such a policy choice is growth-friendly and appropriate for advanced economies.

Figure 8. Adjustment of Composition vs. Revenue-to-GDP and Expenditure Increase

(Percent of GDP)



Source: IMF staff estimates based on country authorities' information.
Note: See footnote in Table 6 for details on the categorization of the composition of adjustment.

Table 7. Selected Fiscal Indicators by Size of Initial Deficit and Composition of Adjustment

(Percent of GDP)

Deficit Category	Largely Expenditure-based Adjustment*			Broadly Equally-based Adjustment			Largely Revenue-based Adjustment		
	OB	TR	CE	OB	TR	CE	OB	TR	CE
High	-11.6	33.9	5.2	-12.1	29.1	2.9			
Medium	-6.9	38.0	3.5	-6.2	34.4	6.2			
Low	-2.4	33.8	2.6	-4.9	22.2	2.9	-3.0	20.0	3.0
Average	-6.9	35.2	3.8	-8.5	31.7	4.6	-3.0	20.0	3.0

Source: IMF staff estimates based on country authorities' information.
Notes: See footnote in Table 6 for details on the categorization of the composition of adjustment.
OB: Overall balance, 2009.
TR: Total Revenue, 2009.
CE: Change in expenditure-to-GDP ratio 2008-09.
*TR and CE do not include Saudi Arabia.

27. **The countries undertaking mixed adjustments or revenue-based plans have relatively low tax ratios or large spending needs for capacity building**. Greece, India, and the United States—the only high deficit countries planning to adjust through balanced tax-expenditure packages—entered the crisis with somewhat lower tax burdens than most high-deficit European countries. This gives these countries the liberty to exploit "revenue space" in the budget that was not available to other countries. In the case of Greece and the United States, it also reflects the fact that the adjustment need is too large to be achieved through expenditure measures alone.[24] In the case of China, the option for largely relying on revenue mobilization is consistent with its focus on infrastructure spending and supporting reforms in pension, health, and education. In Mexico, non-oil revenue-based adjustments also have the purpose of addressing the significant dependency of the budget on oil revenues (in particular, given the impending exhaustion of oil resources), thereby helping to reduce vulnerability to fluctuations in oil prices. Moreover, countries like Greece, India, and Russia have space to mobilize revenue not only by policy changes but also by improving tax compliance.

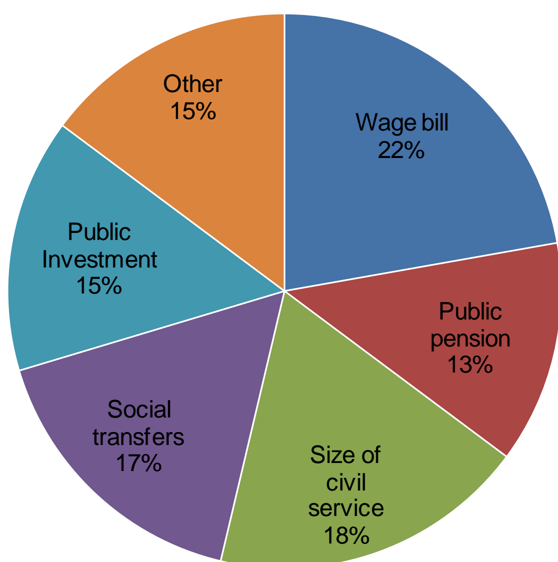
28. **About 40 percent of announced expenditure measures aim at the public wage bill and the size of the public administration** (Figure 9). The type of measures involved in spending cuts also matters for supporting growth and some studies say that cuts involving untargeted transfers and public consumption—the wage bill, in particular—are less harmful to growth than are reductions in public investment.[25] Wage bill reduction may support the choice for leaner and more efficient governments, in particular when combined with public sector rationalization and modernization. It also may support improved competitiveness through the feedback effect from public to private sector wages.[26] Canada, Greece, Ireland, Italy, Latvia, Portugal, Spain, and the United Kingdom have announced wage freezes or a reduction of the wage bill over time, which is also consistent with their comparatively high level of this spending (above 11 percent of GDP, Figure 10). It is important, though, to ensure that high-quality civil servants are properly compensated, and measures should be implemented targeting ineffective areas rather than across the board cuts. Beyond wage cuts, 18 percent of all measures target the size of the civil service, which supports a more comprehensive and permanent rationalization of public administrative structures. (See Table 8 for country details on expenditure measures).

[24] Revenue measures have already been adopted by Greece, under the program supported by EU/IMF financing. In the United States, in particular for the federal government, there is still a need to specify robust revenue measures.

[25] See Alesina and Perotti (1997), and Alesina and Ardagna (2010).

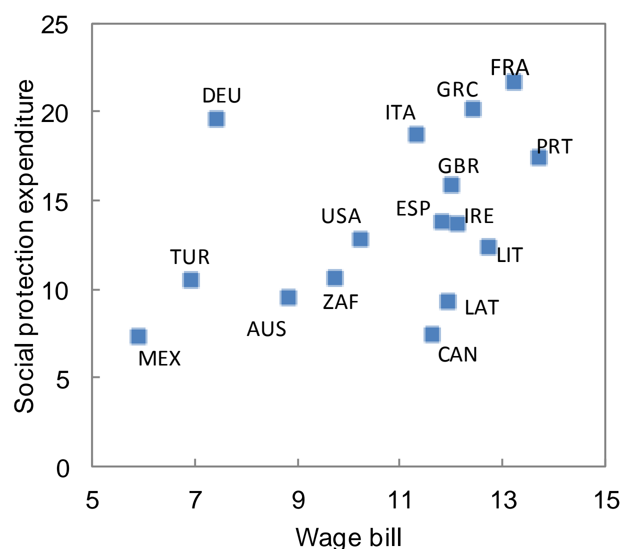
[26] See ECB (2010).

Figure 9. Expenditure Measures
(Percent of total number of measures)



Source: IMF staff estimates based on country authorities' information.

Figure 10. Wage Bill and Social Protection Expenditures
(Percent of GDP)



Source: Eurostat and IMF staff estimates.
Note: Data are for 2008 or latest year available.

29. **Advanced economies are planning cuts in social transfers and defense spending, while public investment has largely been protected.** Advanced countries have a greater focus on social transfer cuts than emerging economies, reflecting the higher share of these expenditures in their budgets (Figure 10). For example, in Germany more than one-third of the announced consolidation measures is estimated to come from social spending cuts. Other countries reducing social transfers are Greece, Ireland, Latvia, Portugal, and the United Kingdom. Public investment has been targeted for cuts primarily in countries that have very large deficits (Greece, Ireland) or needed to frontload their adjustments due to market pressure (Portugal, Spain). Savings in defense and military expenditure have been approved or are under consideration, for example in Germany, the United States, and the United Kingdom, and may be an effective measure to be explored by other countries as well. IMF (2010c) estimates that reducing military outlays in the advanced economies to levels prevailing in the late 1990s could generate savings of about 1 percent of GDP. (See Table 8 for country details on expenditure measures).

30. **Measures affecting direct taxes, especially the personal income tax, dominate on the revenue side** (Figure 11). To the extent that higher direct taxes discourage labor supply and investment, such a development could raise concerns about the impact of consolidation on growth. Fortunately, in a number of countries increases in tax revenues reflect base widening rather than rate increases (Figure 12). PIT measures affect both tax rates (Greece, Latvia, Portugal, the United Kingdom, and the United States) and bases (Germany, Greece, India, Korea, Latvia, Portugal, and the United States). Corporate income tax rate increases

were announced by Portugal (only for large taxpayers). Regarding indirect taxation, increases in the VAT rate (varying from 1 to 4 percentage points) have been adopted by Greece, Mexico, Portugal, Spain, and the United Kingdom. Other measures being planned involve the adoption of green taxes (Germany, Ireland, Korea, and South Africa) and export taxes on commodities (Russia). The adoption of green taxes is welcome and should be expanded: announced measures show the potential array of possibilities of such taxes.[27] Many countries (Greece, India, Italy, Korea, Latvia, Lithuania, Portugal, Turkey, and the United Kingdom) are also adopting measures to strengthen revenue administration in order to fight evasion and mobilize revenues. (See Table 9 for country details on revenue measures).

Figure 11. Type of Revenue Measures

(Percent of total number of measures)

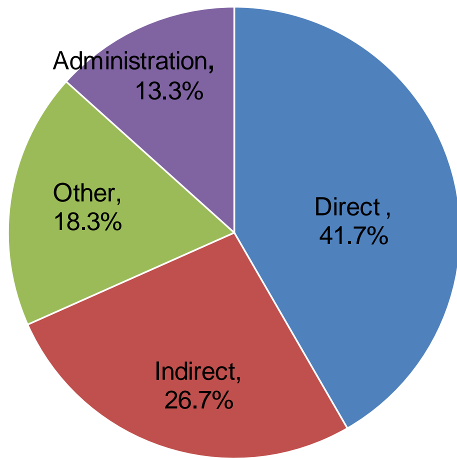
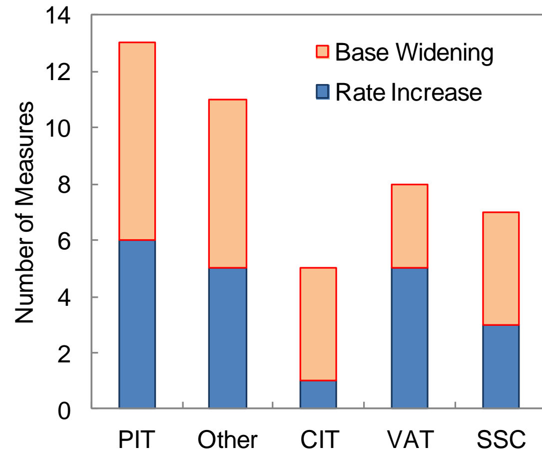


Figure 12. Revenue Measures: Base Widening and Rate Increases

(Number of measures)



Source: IMF staff estimates based on country authorities' information.

[27] Germany's plans include a tax on profits of nuclear power plants and an environmental surcharge on airline passengers. Ireland and South Africa have announced the adoption of carbon emission taxes.

Table 8. Announced Expenditure Measures by Country

Country	Public wage freeze	Moderation in public wage increase	Public pension freeze	Moderation in public pension increase	Reduction in the size of the civil service	Reduction in social transfers	Moderation in social transfer increase	Reduction in public investment	Moderation in increase in public investment	Other expenditure measures
Canada	x									
France	x	x			x					x
Germany					x	x				x
Greece	x		x		x	x		x		
Ireland	x		x		x	x		x		
Italy	x			x	x		x	x		x
Japan										
Latvia	x		x		x	x		x		
Lithuania	x		x		x		x			
Mexico		x								x
Portugal		x		x	x	x		x		x
Russian Federation					x					
Saudi Arabia										x
South Africa										
Spain	x			x			x		x	x
Turkey									x	x
United Kingdom	x				x	x		x		
United States										x

Source: Country authorities' information.

Table 9. Announced Revenue Measures by Country

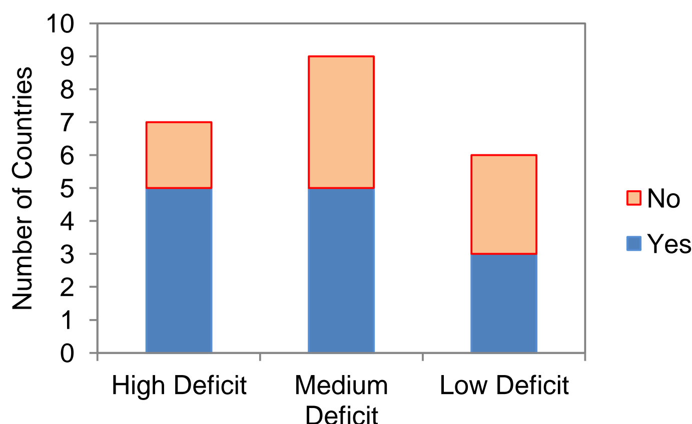
Country	Increase in PIT rate	Widening of PIT tax base	Increase in CIT rate	Widening of CIT tax base	Increase in VAT or sales tax	Widening of VAT or sales tax base	Increase of SSC rates	Widening of SSC base	Increase of tobacco and alcohol excise	Increase of fuel excises	Increase of other tax rates	Widening of tax base	Improvement of tax administration
France	x						x	x			x	x	
Germany		x		x		x	x						
Greece	x	x			x	x			x	x			x
India		x		x		x							x
Ireland											x	x	
Italy													x
Korea		x		x								x	x
Latvia	x	x						x			x		x
Lithuania								x		x		x	x
Mexico					x								
Portugal	x	x	x		x			x					x
Russian Federation							x		x	x	x	x	
Saudi Arabia												x	
Spain					x				x				
Turkey									x	x	x		x
United Kingdom	x				x								
United States	x	x		x									

Source: Country authorities' information.

F. Protecting the Most Vulnerable

31. **Most countries, including nearly all those with large deficits, have announced measures to protect vulnerable groups, especially the unemployed, from the impact of the crisis** (Figure 13). Many countries have extended the eligibility period for unemployment insurance benefits (e.g., the United States), implemented policies to accelerate jobs recovery or used active labor market programs that have allowed firms to retain workers (e.g., in Germany, Japan and Italy, where the increase in unemployment rates was relatively contained). The United Kingdom has announced the indexation of benefits, tax credits, and public service pensions. Greece has introduced surcharges to high pensions applied exclusively to the top 10 percent of pensioners and adopted differentiated increases in reduced and standard VAT rates. Greece and Portugal also intend to strengthen their means-testing mechanisms. Moreover, countries enhancing their revenue administrations also aim at combating tax evasion and reducing inequality, given that high-profile individuals and large corporations tend to invest more in tax-avoidance schemes than wage earners and low-income taxpayers.

Figure 13. Number of Countries with Announced Measures to Protect the Most Vulnerable

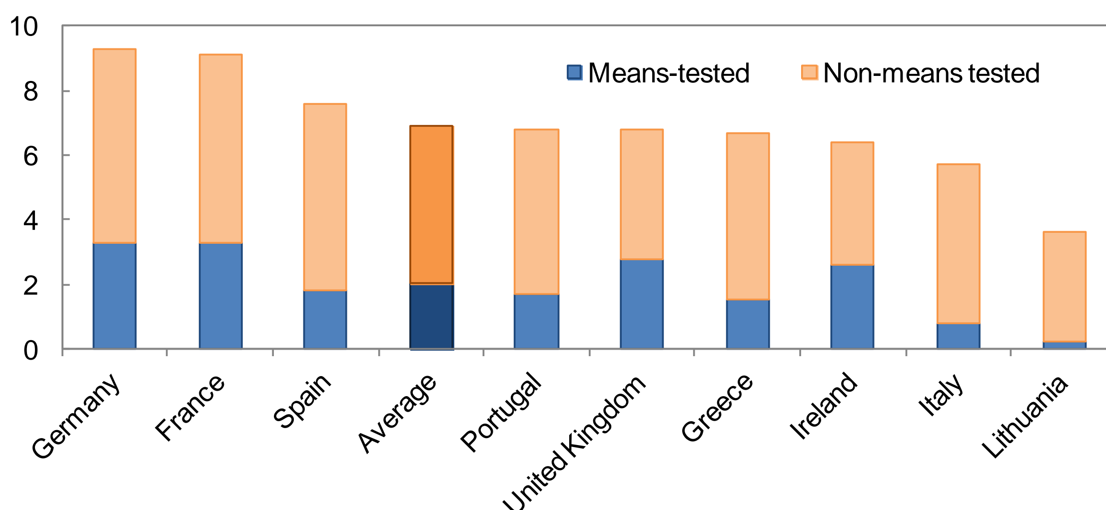


Source: IMF staff estimates based on country authorities' information.
Note: High deficit countries are those with an overall deficit of more than 10 percent of GDP in 2009; medium deficit countries are those with a deficit between 5 and 10 percent of GDP; and low deficit below 5 percent of GDP.

32. **A few emerging economies have announced plans to increase social spending.** For example, Argentina adopted a universal child allowance (estimated at 0.8 percent of GDP), China introduced college tuition subsides for students whose families have financial difficulties, and India intends to expand its food subsidy program. Nevertheless, measures affecting social transfers form a significant part of adjustment plans in many economies, especially advanced ones (see Section III.E).

33. **No country has announced a comprehensive reform of social protection networks to enhance their efficiency and effectiveness, or an evaluation of the impact of the crisis or consolidation process on vulnerable groups.** Countries should develop an overall assessment of the impact of their adjustment plans on the most vulnerable, and propose countermeasures to mitigate the effects. In countries that already operate broad social safety nets, social expenditure effectiveness can be boosted further to avoid wasted resources. For example, the proportion of means-testing in total social spending should be expanded to ensure better targeting, given that this ratio is still low even in advanced economies (Figure 14). Other countries, such as China, India, and South Africa, should still work on increasing the coverage of their safety nets. Integrated approaches that encourage poor families to keep their children in school, or achieve literacy performance levels, while complying with regular health check-up routines, should be explored.

Figure 14. Targeting of Non Age-Related Social Spending in the European Union, 2007 (Percent of GDP)



Source: IMF staff estimates based on country authorities' information.
Note: EU countries shown here are those among the 25 countries covered here.

G. Medium-Term Considerations

34. **Adjustment strategies have not yet fully addressed the significant challenges posed by the growth of medium-term spending pressures, especially for health care.** Most advanced countries have made some effort to contain both short- and medium-term pension-related fiscal pressures, with reforms being more pronounced in high-deficit advanced economies. More is needed in view of the still-large cumulative fiscal costs from future pension liabilities and significant downside risks. Pension reform has been less marked in emerging markets, where short- and medium-term fiscal pressures are also less pronounced; however, these countries are facing the longer term challenge of expanding

pension coverage in a fiscally sustainable manner. Few economies have initiated significant health care reforms. Containing the growth of public health care expenditure while ensuring broad access to high-quality care will need to figure more prominently in fiscal consolidation strategies to avoid finding that current consolidation efforts are gradually unwound over the medium term.

Efforts to contain pension-related fiscal pressures

35. **Many advanced economies have already implemented pension reforms, and only a few are planning additional revisions to help further contain medium-term spending.** Reforms included increases in the statutory retirement age, tighter eligibility, and lower benefits to deliver lower replacement rates (Table 10). If reforms are implemented as planned, retirement ages would be above 65 years almost everywhere by 2030.

36. **While these reforms are likely to help contain medium-term pension pressures, further reforms are needed in many countries, both to deal with remaining spending growth and to address downside risks.** Public pension spending is projected to rise by 1 percentage point of GDP over the next 20 years, on average, in advanced and emerging economies (IMF, 2010c). In most advanced economies, including Australia, Canada, France, Germany, Italy, Japan, Portugal, the United Kingdom, and the United States, where significant reforms have been undertaken in the past, the pension spending increase is projected to be relatively modest, in spite of population aging (Figure 15). However, these medium-term pension spending projections are highly dependent on the assumptions surrounding employment and productivity, which are particularly hard to forecast given the current uncertainties about the longer-term impact of the crisis on the real economy.

37. **Major pension reforms are underway in a few advanced economies facing significant pressures**. For example, Greece passed an important pension reform in July 2010 that is estimated to limit future fiscal pressures to no more than 2.5 percent of GDP. It will work mostly by gradually increasing the statutory retirement age and cutting benefits. On March 3, Ireland released its *National Pensions Framework,* which aims to increase private pension coverage, especially for low- and middle-income groups, and maintain state support for pensions, while restoring fiscal sustainability of the pension system by 2050. The French parliament has approved an increase in the retirement age from 60 to 62 years. On July 29, 2010, the Italian parliament increased public- and private-sector retirement ages as part of an austerity plan passed into law, estimated to yield savings of €1.45 billion euros through 2019.[28] However, Korea and Spain, countries with above average pension pressures,

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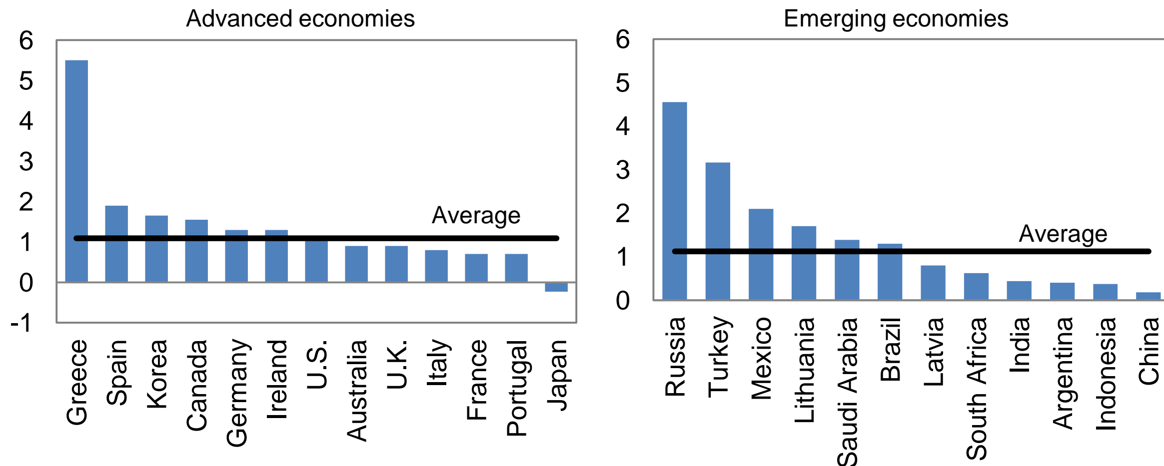
[28] The reforms include an increase in the retirement age for women in the public sector on January 1, 2012, immediately from 61 to 65 years. The retirement age for private-sector workers will be adjusted according to life expectancy projections (see http://www.ssa.gov/policy/docs/progdesc/intl_update/2010-09/index.html).

have not yet planned major reform efforts (though Korea increased the retirement age in 2007 to 65 years for those retiring after 2033).[29]

38. **Progress has been slower in most emerging market economies, perhaps because medium-term spending pressures are more subdued.** In China, India, and Indonesia, for example, which generally have lower pension expenditure due to relatively younger populations and less extensive coverage, the challenge is to expand pension coverage, but in a manner that does not generate fiscal imbalances as these systems mature. In June 2010, the Brazilian Parliament approved a 7.7 percent increase in public pensions in Brazil. Furthermore, a parliamentary provision, which eliminated the adjustment factor intended to link benefits to demographic changes (fator previdenciário), originally set up in 1999 to encourage workers to defer retirement, was approved but subsequently vetoed by the president, so that the ―fator previdenciário” remains in force. In South Africa, the retirement age for men is being lowered by two years to bring it in line with that for women. For emerging economies with high household savings rates (such as China), increased pension coverage would also support efforts to make domestic demand the primary catalyst of growth (see Baldacci and others, 2010).

Figure 15. Projected Change in Public Pension Expenditure, 2010-30
(Percent of GDP)



Source: IMF (2010c).
Note: Estimates of pension-related fiscal pressures for Greece do not include the impact of the most recent reform, which is anticipated to contain these pressures substantially.

39. **However, in some emerging economies with more extensive pension coverage and older populations, some efforts are being made to contain fiscal gaps.** Russia has recently increased contribution rates but did not address spending. Latvia and Lithuania have

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[29] Though the Spanish government has signaled its intensions to possibly increase the statutory retirement age by two years.

implemented emergency measures to contain the fiscal impact of the crisis—cutting benefits and diverting contributions from the second pillar—but have not yet planned any major efforts to address longer term issues. Mexico, on the other hand, introduced a system of personal accounts in 1995, although incremental changes might be needed to contain medium-term fiscal pressures deriving from workers covered under the old system. In the absence of further reforms, the statutory retirement age in emerging market economies is likely to remain below 65 years by 2030, except in Argentina and Brazil, where the retirement age for men is already 65 years.

Table 10. Planned or Implemented Pension Reforms

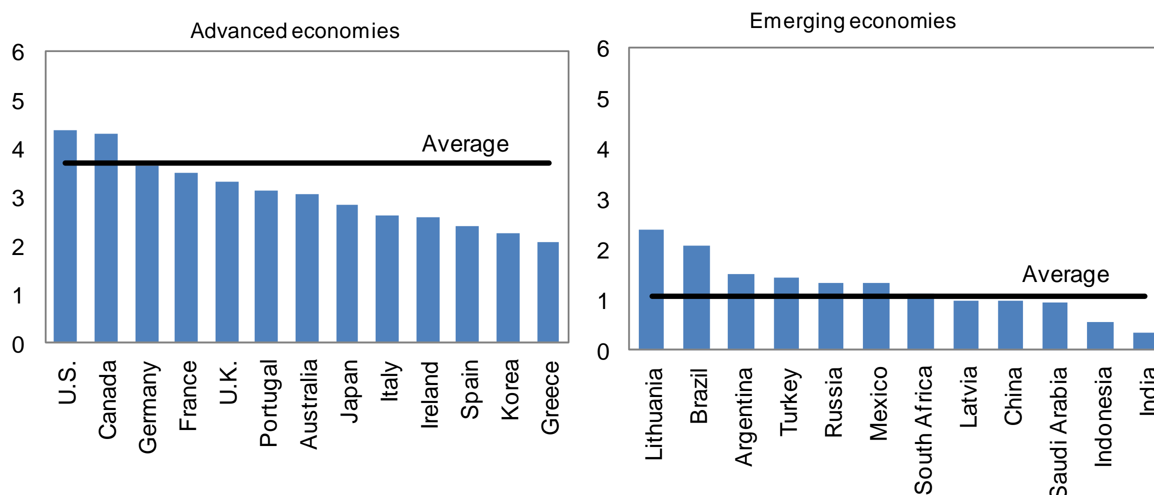
	Change in Pension Spending (2010-30)	Pension Reform in 09/10 [1]	Change in Retirement Age (Years)	Retirement Age 2010 (Years)	Retirement Age 2030 (Years)	Expansion of coverage
Advanced economies						
Australia	0.9	yes	2	65	67	
Canada	1.6			65	65	
France	0.7	yes	2	60	62	
Germany	1.3	yes	2	65	67	
Greece [2]	5.5	yes		65	65	
Ireland	1.3	yes	3	65	68	
Italy [3]	0.8	yes		65	65	
Japan	-0.2			65	65	
Korea	1.7	yes	5	60	65	
Portugal	0.7			65	65	
Spain [4]	1.9	yes	2	65	67	
United Kingdom	0.9	yes	1	65	66	
United States	1.1	yes	1	66	67	
Emerging economies						
Argentina	0.4			65		
Brazil	1.3	yes		65		1
China	0.2	yes		60		1
India	0.4			58		
Indonesia	0.4			55		
Latvia	0.8	yes		62		
Lithuania	1.7	yes		62.5		
Mexico	2.1			65		
Russia	4.6	yes		60		
Saudi Arabia	1.4			60		
South Africa	0.6	yes	-1	61		
Turkey	3.2			60		

Sources: Country authorities, European Commission (2009), IMF-ILO (2010), OECD (2009), and IMF staff estimates.
[1] Plan or enacted pension reform.
[2] The estimated change of pension-related spending for 2010-30 does not include the 2010 reform impact.
[3] On January 2012 the retirement age for women employed in the public sector will increase from 61 to 65 years.
[4] Discussion over Spanish reform program are still ongoing.

Efforts to contain health-related spending pressures

40. **Health care constitutes the key challenge in stabilizing age-related spending pressures in most advanced and emerging economies**. Health care spending is projected to rise by 3½ percentage points of GDP in 2010–30 in advanced economies due to technology-induced cost pressures and, to a lesser extent, aging (Figure 16).[30] A reform priority in advanced economies should be to contain the growth of spending, while ensuring broad access to high-quality health care. For emerging economies, the challenge is to expand basic coverage, which is currently often insufficient to protect against the risk of illness and applies only to a small share of the population, at a reasonable cost and without generating fiscal pressures.

Figure 16. Projected Change in Public Health Expenditure, 2010-30
(Percent of GDP)



Source: IMF (2010c).

41. **Recent cost-containment efforts in high deficit advanced economies, focusing on lowering spending on pharmaceuticals, are unlikely to be sufficient to tackle this longer-term challenge.** Germany, Greece, France, Ireland, Italy, Spain, the United Kingdom, and the United States are planning or are implementing measures to lower public spending on pharmaceuticals. Those include a three-year price freeze on pharmaceuticals covered by statutory health insurance and rebate increases to be paid by drug manufacturers in Germany; introducing a price-referencing system, cutting prices on certain drugs, and expanding the list of medications that are not reimbursed in Greece; slashing reimbursement rates for a number of drugs and imposing price caps on generics in France; centralizing pharmaceutical procurement and reducing generics prices in Italy; cutting prices of off-patent

[30] Projected health care spending increase could actually nearly double under a more pessimistic scenario. For estimates of health pressures under such a more pessimistic scenario see IMF (2010c).

drugs and plans to introduce reference pricing and generic substitution of pharmaceuticals in Ireland; strengthening reference-value pricing and lowering prices of pharmaceuticals not included in the system of reference pricing in Spain; and plans to introduce value-based pricing for pharmaceuticals in the United Kingdom. Given the modest share of pharmaceutical outlays in total public health outlays (about 15 percent in the OECD), the effects of these reforms—while positive—are not likely to be very large.

42. **Despite the 2010 health care reform in the United States, public health care spending is likely to continue to consume a growing share of the federal budget.** Under the 2010 reform, Medicare payment cuts would be at least partly offset by the expansion of eligibility and the provision of insurance subsidies, leaving net savings from the reform highly uncertain. Supplementing Congressional Budget Office (CBO) projections for federally mandated spending with estimated spending increases for subnational governments, IMF staff forecast that general government health spending will rise by 4½ percentage points of GDP in the United States over the next 20 years. There are also substantial upside risks to these projections. Under less optimistic assumptions on Medicare payment reductions and the cost of subsidies, health care outlays could be 1 percentage point of GDP higher in 2030, although there is a possibility that more effective therapies may make a dent in the trend cost increases.

43. **In some advanced economies, broader health care reforms are currently being considered.** In the United Kingdom, the government's white paper contains radical reform plans to give more control over the National Health Service (NHS) to groups of primary care doctors. Under the reform, new arrangements of primary care doctors—called primary care consortia—would be given the power to plan health care services and spending for their patients, which is estimated to yield efficiency savings of 1.4 percent of GDP by the end of 2014, to be reinvested to support improvements in quality and outcomes.[31] The government plans to introduce outcome-based targets for the NHS and to reduce its administrative spending by 45 percent. In Germany, reform proposals include the reversal of the reduced health care contribution rate for stimulus purposes in 2011, and short-term measures to cap expenditure and reap efficiency gains. It is estimated that these measures will likely save €11 billion in 2011 (0.4 percent of GDP), equivalent to the expected health budget deficit in the same year. Beyond 2011, further steps will be taken to ensure long-term financial sustainability through enhancing competition and efficiency in the system and through higher individual contribution rates, with limited subsidization of additional health insurance costs. In Portugal, reform plans focusing on management and control of health expenditure are estimated to bring fiscal savings of between 0.2–0.4 percent of GDP over the next three

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[31] The plan would create 500 primary care consortia, each caring for about 100,000 patients. Consortia would be responsible for determining the services patients needed and they would also be accountable for overspending, with certain GPs taking new administrative roles in the consortia. Patients would be able to choose where they access treatment. The consortia would control 80 percent of the national health budget by end-2013.

years.[32] These reforms focus on strengthening internal control of the NHS; implementing public service contracts and incentive mechanisms; and rationalizing expenditure on pharmaceuticals, medical material, and supplementary diagnostic and therapeutic services. The Ministry of Finance also intends to publish a monthly report on NHS budget execution, to define rules for determining multi-annual health budgets, and to carry out audits in sectors where expenditure growth is high.

44. **Fewer reforms are planned in emerging economies.** The health care reform currently being implemented in Lithuania aims at strengthening regulation of medication prices, restructuring services, and consolidating medical institutions. In Turkey, strengthening the legal basis for public financial management is expected to improve health spending effectiveness through controlling health costs while maintaining standards. In particular, the enactment of the secondary legislation for the Public Financial Management and Control (PFMC) Law has established mechanisms to improve relations between programs and budgets, consistent with international standards and likely to lead to more efficient health spending.

45. **More fundamental reforms are needed to contain the growth of spending while ensuring broad access to high quality health care.** Measures will need to strengthen supply-side incentives or reduce the demand for public health services. In general, supply-side measures, such as global budgets for provider reimbursement and evaluation of the cost effectiveness of medical treatments and technology, are most effective at containing costs. On the demand side, measures include increasing cost sharing to discourage moral hazard and reducing tax expenditures from subsidies for private health insurance. Past reforms—including budget caps in a number of European countries and managed care in the United States in the 1990s—provide valuable lessons for future reforms, although the appropriate policies will be country-specific (IMF, 2010c).

H. Fiscal Institutional Arrangements

46. **Strong fiscal institutions facilitate medium-term adjustment**. As the needed adjustment is large, and given the fragility of the recovery cannot all be implemented upfront, a prolonged fiscal adjustment effort will be needed. In this situation, strong institutional setups can help keep fiscal plans on track.[33]

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[32] See Stability Program (2010–13). Key measures include internal control; implementation of public service contracts and incentive mechanisms in the National Healthcare Service; medicine policy, electronic prescriptions, and supplementary diagnostic and therapeutic services.

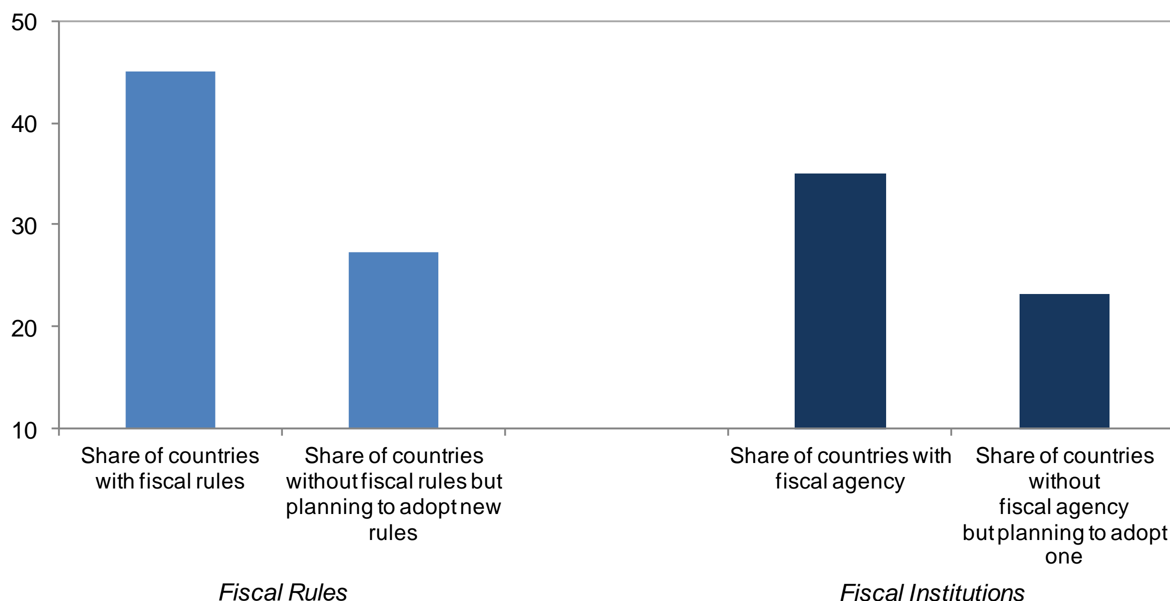
[33] There is empirical evidence that the use of national fiscal rules is associated with stronger budgetary performance (see e.g., Debrun and others, 2008, and European Commission, 2006). It has also contributed to the success of fiscal consolidations (see, Guichard and others, 2007, and European Commission, 2007).

47. **Some countries have already undertaken reforms to introduce or strengthen fiscal rules and institutions.** Among those that have made institutional changes in response to the crisis with a view to putting public finances back on a sustainable footing is Germany, which had prepared the adoption of its constitutional structural budget balance rule pre-crisis but where this role is now a cornerstone of its exit strategy. The United Kingdom set up an Office for Budget Responsibility and is in the process of drafting legislation to make it permanent. The government has also established a fiscal mandate (to balance the cyclically adjusted current budget and put the net public sector debt ratio on a downward path by 2015/16) to guide consolidation plans. Japan recently announced its Fiscal Management Strategy, including a pay-as-you-go rule that requires offsetting measures to any deficit-widening spending or revenue initiatives. And the United States adopted the Statutory Pay-As-You-Go-Act of 2010, though some important programs were exempted, in some cases temporarily. It has also set up of a fiscal commission tasked with developing options to reach primary balance by 2015. However, the need for a supermajority of 14 out of 18 members to pass recommendations could be a challenge. Moreover, at the EU level proposals are being considered on how to improve the effectiveness of the EU‘s fiscal surveillance framework (see Box 6 in November *Fiscal Monitor*, IMF 2010b.)

48. **Several other countries are planning fiscal institutional reforms.** About 30 percent of countries that do not yet operate with national fiscal rules plan to adopt one (Figure 17). The share is somewhat lower (about a quarter) for the inception of new fiscal agencies and plans are still vague in most cases. Among the countries that plan to adopt new fiscal rules is France, where a working committee has made proposals to introduce a fiscal rule in the constitution. In Latvia and Lithuania, a fiscal responsibility law and a new deficit rule, respectively, are under preparation. Greece‘s new Fiscal Responsibility and Management Act extends the time-horizon and scope of fiscal policymaking, introduces a top-down sequence to budget preparation, tightens expenditure controls, and increases parliamentary scrutiny of the budget. The Law also includes the principles for establishing a fiscal rule at a later stage.

49. **However, there remains considerable scope to strengthen fiscal and budget institutions to support the consolidation process.** In particular, most G-20 governments need to improve the breadth, depth and timeliness of fiscal reporting, forecasting, and risk management to ensure that their consolidation efforts are based on a comprehensive, up-to-date, and robust understanding of the fiscal position. To aid consolidation planning, fiscal frameworks need to set more specific, time-bound targets for one or more broad fiscal aggregates and to be supported by more comprehensive and binding medium-term budget frameworks. For example, in the United States, the President‘s draft budget includes detailed medium-term revenue and spending projections, but not a Congressionally-approved medium-term budget document. To ensure medium-term plans are implemented, budget preparation and approval processes need to follow a top-down sequence. Italy, for example, would benefit from strengthening its budget preparation process, aiming at a tighter top-down process.

Figure 17. Plans to Adopt Fiscal Rules and Fiscal Agencies
(Percent)



Source: Country authorities' information.

IV. Conclusions

50. **Overall, the countries reviewed in this paper have made reasonable progress in defining exit strategies.** Most countries plan to undertake fiscal consolidations in the coming years, with the few exceptions being countries that were little affected by the crisis and expect to be able to achieve their fiscal targets largely through the closing of the output gap. While countries that are under acute market pressure have appropriately front-loaded their adjustments, most other countries are seeking a more gradual approach that balances the potentially competing demands of maintaining credibility and supporting the recovery. In most cases, adjustment programs are also intended to be reasonably growth-friendly—with an emphasis on cuts in spending, especially the public wage bill—and many countries have included measures to offset some of the impact of the crisis on vulnerable groups.

51. **Nevertheless, strategies in some countries fall short in some critical areas:**

- Few countries have explicitly committed to a deficit path that would reduce debt ratios to prudent levels in the long term. As a result, there continues to be considerable uncertainty about the long-run objectives of fiscal policy in many countries. Reforms being debated in the European Union that would give a more prominent role to the 60 percent of GDP Maastricht debt ceiling in the setting of fiscal policy may help address this shortcoming in many countries.

- Few countries have made serious inroads in tackling rising health care costs, which are a formidable medium- and longer-term challenge for nearly all of them.

- With the exception of those that are front-loading their adjustments, relatively few countries have spelled out the measures underlying their adjustment efforts in sufficient detail. Even among front-loaders, the degree of detail is much lower for plans at the end of the adjustment period than at the beginning.

- While efforts have been made to shield the most vulnerable from the impact of the crisis, measures have mostly been implemented on a piecemeal basis. No country has undertaken a comprehensive reform of social spending with a view to increasing efficiency, for example through improved targeting.

- In some countries, fiscal institutions need to be strengthened to help ensure that fiscal targets are observed.

- In several countries, including some with the largest adjustment needs, the macroeconomic assumptions underlying the adjustment program are more optimistic than other publicly available figures. It will be essential that country authorities update their macroeconomic scenarios regularly if data suggests that growth is likely to be lower than they assume, to avoid compromising the credibility of their adjustment programs.[34]

[34] The relatively optimistic growth forecasts in some countries also prompt the question of how fiscal policy should respond should growth turn out to be slower than country authorities project. In principle, countries with fiscal room should respond to modestly slower growth by allowing the automatic stabilizers to operate. If growth threatens to slow appreciably more than expected in the baseline WEO projections, advanced economies with fiscal room should also consider slowing the pace of underlying adjustment by scaling back measures.

APPENDIX. THE AUTHORITIES' ADJUSTMENT PLANS: COUNTRY CASES[35]

Argentina

The Argentinean authorities do not anticipate implementing an explicit exit strategy beyond the action of automatic stabilizers on the revenue side when the output gap closes. The authorities envisage maintaining the policy framework under which they have operated since 2003 (including the use of export taxes, and aiming for ‗twin'—external and fiscal—surpluses). Going forward, on the revenue side the focus will on be administrative measures that raise compliance. On the expenditure side, public investment will remain high—particularly for energy, infrastructure, and housing—at an average level of about 3.1 percent of GDP (above the average of the last 15 years) over 2010-12, but lower than in 2009 when investment was used as a counter-cyclical tool in response to the international financial crisis. Over the next few years, the authorities expect their financing needs to be satisfied by domestic sources, including pension funds, with very little dependence on external financing.

Nevertheless, some policy measures were recently introduced both on the revenue and expenditure sides, though their impact on the fiscal policy stance is difficult to quantify. On the revenue side, there has been a PIT rate hike on small tax payers (the ―Monotributo"), a VAT rate increase on some technological products, an increase in excises on tobacco, and the introduction of new tax on cellular phone usage (to finance Olympic activities). Improvements were made in tax administration with a view to increasing compliance—in particular of high-income earners—by drawing on information from credit card use, purchases of luxury cars, and private school attendance. On the expenditure side, ―Universal Child Allowances" were created in December 2009, and are estimated to cost US$2.5 billion (about 0.8 percent of GDP) a year. Plans for interest rate subsidies have been announced, with the aim of financing investment projects by small and medium-sized enterprises.

Australia

The authorities' project a budget surplus in 2012/13, three years ahead of the 2009/10 budget projections. Australia's medium-term fiscal strategy has three objectives: (i) achieving a budget surplus, on average, over the medium term; (ii) keeping taxation as a share of GDP below the 2007/08 level, on average; and (iii) and improving the government's

[35] The summaries were prepared by Emre Alper, Olivier Basdevant, Fabian Bornhorst, Nina Budina, Carlos Caceres, Giovanni Callegari, Stephanie Eble, Asmaa El Ganainy, Marc Gerard, Jiri Jonas, Alvar Kangur, Philippe Karam, Daehaeng Kim, Alexander Klemm, Andrea Lemgruber, Geremia Palomba, Andrea Schaechter, Anna Shabunina, Joong Beom Shin, Justin Tyson, and Jaejoon Woo. The summaries have benefited from input and suggestions by colleagues in the IMF's area departments.

net financial worth over the medium term. The government projects the Commonwealth budget deficit to fall by 4½ percentage points of GDP from 2009/10 through 2013/2014. The consolidation is front-loaded with more than half of the planned adjustment to be achieved in 2011.

The fiscal consolidation plans includes several elements. As the economy recovers, the deficit exit strategy will see improvements in expected tax receipts allowed to flow to the budget, while maintaining the commitment to keep tax revenue as a share of GDP below the 2007/08 level; and real growth in spending held to 2 percent a year until the budget returns to surplus. In addition, fiscal stimulus is being phased out as planned. Once the budget returns to surplus, real spending growth will be held to 2 percent a year, on average, until the budget surplus is at least 1 percent of GDP.

In July 2010, the government announced a tax reform package. The package includes the introduction of a mineral resource rent tax (MRRT) with a tax rate of 30 percent operative in July 2012 on iron ore and coal. The new tax will fund a cut in the company tax rate from 30 to 29 percent starting in 2013-14, a new infrastructure fund, and a boost to superannuation.

The government announced in the 2009/10 budget major reforms to the pension system that will improve adequacy and help alleviate longer-term fiscal pressures. The objectives are to strengthen the financial security of pensioners while also ensuring that the system remains sustainable into the future. These reforms include boosting weekly pension payments, especially for single rate pensioners, with savings made in the other components of spending over the medium term. The income test for pensions has been tightened, and the qualifying pension age will be progressively increased from 65 to 67 years. Means testing of the private health insurance rebate and reforms in the family payment system, as well as long-term health reforms, are being implemented but still require parliamentary approval. The Council of Australian governments, with the exception of Western Australia, reached an agreement on significant reforms to the health system—the establishment of a National Health and Hospitals Network—with a view to improving the delivery and the sustainability of the health system.

Australia's fiscal adjustment strategy is aided by its fiscal and budgetary frameworks. The *Charter for Budget Honesty* (1998) sets out the broad institutional framework for the conduct of fiscal policy. A key requirement of the Charter is that each budget update must include a fiscal strategy statement covering the budget and following three financial years which, among other things, specifies the government's fiscal objectives and targets. The government's fiscal objectives are specified in its medium-term fiscal strategy. The fiscal framework was flexible enough to respond to the financial and economic crisis and was thus neither revised nor put into abeyance.

Brazil

While a gradual exit from crisis-related fiscal measures is envisaged, no further adjustment is planned, reflecting in part the relatively benign macroeconomic and fiscal outlook. The authorities' medium-term fiscal objectives—a primary surplus of around 3.3 percent of GDP and reduction of the net debt-to-GDP ratio—will be challenging for 2010 without additional fiscal measures. Policy lending, which is outside the primary surplus target and does not affect net debt, is expected to continue in the medium term, contributing to higher gross debt and interest expenditure.

In 2010, stimulus-related tax incentives are being phased out gradually while quasi-fiscal stimulus remains in place. The schedule for reversing exemptions or tax reductions for certain products (e.g., capital goods) has been pushed back, in some cases indefinitely. However, the fiscal costs associated with this delay are small. New policy lending is projected at 3.0 percent of GDP in 2010, down from 3.2 percent of GDP in 2009.

No structural fiscal reforms are envisaged for the near future, but key aspects of the 2003 social security reform are in jeopardy. The fiscal cost of not addressing social security imbalances will increase gradually before snowballing as demographic developments turn adverse from 2030 onwards. Social security and tax reform, the latter tied to a reform of sub-national finances, are key priorities for the authorities. Reducing budget rigidities that result from complex revenue sharing arrangements, earmarking, and constitutional spending provisions would enable higher public savings and create fiscal space for investment.

Fiscal policy will continue to operate under the current fiscal framework, which builds on the Fiscal Responsibility Law, and has served Brazil well. While the framework has contributed considerably to consolidating Brazil's public finances, several areas for improvement have emerged. They include (i) specifying a medium-term debt target; (ii) relying on a more comprehensive measure of fiscal policy that includes interest payments and policy lending; and (iii) using consistent accounting standards and avoiding the use of adjustors and ad-hoc changes to fiscal targets, possibly by using cyclically adjusted/ structural indicators for fiscal policy analysis.

Canada

The 2010 Budget confirms the government's commitment to deliver the second year of the Canada Economic Action Plan, and charts a course to bring Canada's finances back to balance over the medium term. The deficit for 2009-10[36] is projected to be cut by

[36] This projection takes into account the planned wind-down of the Action Plan and the spending growth restraint.

almost half in 2011-12 to 1.6 percent of GDP, and by another third to 1.0 percent of GDP in 2012-13. By 2014-15 it will be near balance (deficit of 0.1 percent of GDP).

The plan is based on ending the stimulus Action Plan in time, and on restraining growth in spending through targeted measures. The latter is estimated to yield CAN$17.6 billion in proposed savings over five years when the recovery is secure. As such, program spending is expected to decline from 15.6 percent of GDP in 2009-10 to 13.2 percent of GDP in 2014-15. In this vein, the expenditure saving measures involve restraining growth in national defense spending, capping the international assistance envelope at 2010-11 levels, containing the administrative cost of government (government operating expenditures) including via a freeze on salaries at various ministerial and departmental levels, and strategically reviewing government operations aimed at reducing costs while improving efficiency. In particular, departments are to assess all their programs and identify the 5 percent that represent the lowest priority and lowest-performing ones for cuts, with projected savings of CAN$287 million (0.03 percent of GDP) by FY 2012-13.

The government does not intend to raise taxes or to cut major transfers to persons (to seniors, children and Employment Insurance) and other levels of government (in support of health care and social services and Equalization). However, further measures are intended to protect the integrity of the Canadian tax system with expected savings of CAN$355 million in 2010-11 and rising to CAN$625 million by 2014-15 (less than 0.05 percent of GDP).

With a small and manageable deficit and debt levels relative to other countries, fiscal sustainability is not an immediate concern. The government net debt-to-GDP ratio had declined to 23.5 percent by 2007 (the lowest debt-to-GDP ratio among G-7 countries at the onset of the crisis) and is projected to increase by only 5.9 percentage points between 2007 and 2014. However, ageing-related pressures are high, in particular from the unreformed health care system. The 1997 pension reform contained some stabilizing provisions to address imbalances.

China

While fiscal targets beyond 2010 have still to be decided, the authorities have indicated a preference for a gradual return to balanced budgets. The 2010 budget balance is expected to remain broadly unchanged, at a deficit of 2.8 percent of GDP, with a continued focus on infrastructure spending, a reduction in the tax burden, and incentives to boost purchases of consumer durables and autos. For 2011, the authorities have indicated that any eventual withdrawal of fiscal stimulus would be measured and gradual. The authorities also intend to maintain policy flexibility to properly respond to any unexpected global economic developments. Over a longer horizon, they aim at a gradual return toward budget balance, noting that China‘s strong fiscal position going into the global crisis afforded it the space

needed for proactive countercyclical fiscal policy. Medium-term plans for revenue and expenditure measures or fiscal institutional reforms have not been spelled out.

Fiscal structural reforms will focus on building China's social safety net, particularly in pensions, healthcare, and education. Old-age insurance schemes in urban areas will be further improved to address their systematic deficits and to expand their coverage; the pilot program for the new rural social pension programs, which started in 2009, will be expanded, with an intention to roll out to the entire rural population by 2020. In 2009-11, the Government also plans to provide substantial budgetary resources to support reforms in the health and education sectors. These reforms would eventually contribute to a sustained rebalancing of growth toward private consumption, while the fully-fledged reforms, and their benefits, may come on stream in the medium to longer term.

With the low level of public debt, a recent history of fiscal prudence, and favorable growth-interest rate differential, fiscal sustainability is not a major concern for China. General government gross debt is expected to be around 20 percent of GDP at end-2010. Fiscal reforms and medium term adjustments are motivated to ―transform the growth model" — rebalancing it toward private consumption. The authorities will continue to implement and refine measures to increase household income and private consumption, particularly by increasing rural household income, basic pensions, benefits for special care recipients, and minimum subsistence allowances.

France

The medium-term fiscal plan is to reduce the deficit to 3 percent of GDP by 2013 as set out in France's Stability Program. The plan envisages containing real public expenditure growth to 0.9 percent annually between 2010 and 2013, mainly through extending spending control at the central government to local governments and social security.

A mix of expenditure and revenue measures is planned, with some specifics still to be spelled out. While expenditure reduction at the central government level is based, in part, on the policy of non-replacement of a fraction of retiring civil servants, adjustment measures at the other levels are less specific. The introduction of a three-year budget framework should help with the consolidation. Measures on the revenue side include higher taxation of income, stock options, retirement packages, capital gains and dividend income, as well as phasing out tax expenditures. Earlier envisaged revenue measures include the reversal of the 0.6 percent of GDP revenue loss in 2010 due to the abolishment of the local business tax and the introduction of new green taxes.

The authorities have an ambitious reform agenda (pension reform, stricter controls of local government finances) that is being gradually implemented. Both houses of

Parliament have approved a pension reform that raises the retirement age from 60 to 62, and the law is expected to be signed shortly.

The adoption of a fiscal rule is being considered by the authorities. Proposals have been made by a working committee to introduce a fiscal rule in the Constitution.

Germany

The authorities’ aim to reduce the overall general government deficit to 3 percent of GDP by 2013, at the latest, and the structural federal government deficit to 0.35 percent of GDP by 2016. These objectives have been spelled out in the German Stability Program (January 2010), are in line with the constitutional “debt brake rule,” and were confirmed in the recent announcement (July 2010) of the medium-term budget plans for 2011-14. The authorities aim for a gradual adjustment, starting in 2011, consistent with the requirements of the debt brake rule for an adjustment in “broadly equal steps” until 2016 when the rule takes full effect.

A mix of expenditure and revenue measures has been announced with a bias for expenditure cuts. These measures have been adopted by the cabinet but not yet by parliament. More than one-third of the cumulative savings until 2014 are accounted for by social spending cuts. Wage and employment cuts are also foreseen in the public administration (including cuts of 10,000 positions by 2014, and freeze of the Christmas bonus from 2011 onwards) and defense. The medium-term plan also includes efficiency gains in the public administration and the health care system. Revenue measures in the medium-term plan include the reduction of tax exemptions, a new tax on profits of nuclear power plants, an environmental surcharge on airline passengers, as well as the introduction of a financial transaction tax (from 2012). Moreover, more recently the government adopted a plan to reverse the reduction in the health insurance contribution rate (from 14.9 percent to 15.5 percent) that formed part of the fiscal stimulus (this still awaits parliamentary adoption).

No major fiscal structural reforms have been announced. The government published in July 2010 its health care reform plan which, however, addressed only short-term financing needs. Pension reforms, including a gradual increase in the retirement age from 65 to 67 years by 2029, had already been adopted pre-crisis. A discussion on restructuring the military is underway and the medium-term budget plan includes savings for the years 2013-14.

Germany’s constitutional fiscal rule, adopted in June 2009, is the key anchor for the exit plans. Even though the rule was prepared prior to the crisis, it is now considered, together with the requirements under the SGP, to bind and guide fiscal policy. It caps the structural federal budget deficit at 0.35 percent of GDP from 2016, while the states need to balance their structural budgets from 2020.

Greece

The fiscal adjustment strategy aims at bringing the general government deficit below the Maastricht criterion of 3 percent of GDP by 2014; thereafter the budget would continue to adjust until a primary surplus of 6 percent of GDP has been reached, so as to ensure debt sustainability over the medium term. Adjustment has been heavily front-loaded with 3.5 percent of GDP in measures to be taken in 2010, in addition to the 5 percent of GDP measures already in place, to restore market confidence; bring the fiscal deficit to more financeable levels, and secure an earlier recovery. In addition, all fiscal measures for 2010-13 have been fully identified to strengthen the program‘s credibility.

The package is broadly balanced between revenue and expenditure measures. Expenditure measures are estimated at 5.2 percent of GDP. The elimination of the Easter, summer, and Christmas pensions and wages, as well as cuts in allowances and top pensions are frontloaded and will, by themselves, yield 2 percent of GDP of the 11 percent total package. Other expenditure cuts involve employment reductions, cuts in discretionary and low-priority investment spending, untargeted social transfers, consolidation of local governments, and lower subsidies to public enterprises. Revenue measures add another 4 percent of GDP to the package. On the revenue side this includes an increase in the standard VAT rate from 21 to 23 percent and in the reduced rate from 10 to 11 percent, moving lower-taxed products such as utilities, restaurants and hotels to the standard VAT rate, and increasing excises on fuel, cigarettes, and tobacco to bring them in line with EU averages. Those measures yield 2.1 percent of GDP. The remaining measures cover higher assessment of real estate; a temporary crisis levy on profitable firms; presumptive taxation; taxes and levies on unauthorized establishments and buildings; and new gaming royalties and license fees.

A number of fiscal structural reforms are part of the adjustment efforts. The authorities passed in July a major pension reform that will limit the increase in pension spending during 2010-50 to 2.5 percent of GDP. While the reduction in pensions will be phased in pro-rata starting 2013, the increase in the retirement age will be fully effective in 2015. Further, the authorities are initiating a functional review of the public administration and social benefits.

Fiscal institutional reforms are being strengthened. A new budget law was passed in July that overhauls budget preparation, execution, and monitoring procedures to support the fiscal consolidation strategy and to enshrine fiscal discipline at the general government level. The new law introduces an annual rolling three-year fiscal and budgetary strategy for the consolidated general government, top-down budgeting with medium-term expenditure ceilings for the state budget, and commitment controls to ensure spending is in line with budget ceilings. It also requires supplementary budgets for any overspending, establishes contingency reserves for unforeseen events, modernizes audits, and strengthens accountability and transparency, including by creating a parliamentary budget office. Most

elements of the new legislation will become effective for the preparation of the 2011 budget. Importantly, the new law extends budgeting and reporting obligations and commitments to all local governments, social security funds, and other entities. The law also includes the principles to support fiscal consolidation after the expiration of the government‘s current three-year program, which specifies annual fiscal targets. It does so by including the general principles and basic elements for establishing a fiscal rule that could be introduced at a later stage. These principles emphasize comprehensive coverage, medium-term focus, transparency, and credibility, among others. Together with improved tax administration, the structural fiscal reforms are estimated to yield 1.8 percent of GDP in 2013.

India

The government plans to gradually revert to a path of fiscal consolidation. Based on the medium-term strategy outlined in the Thirteenth Finance Commission report of December 2009, the government targets a reduction in the debt-to-GDP ratio of about 7 percentage points (to 68 percent) by 2015. The pace of adjustment is planned to be about even over time, except for the withdrawal of fiscal stimulus that will occur in 2011.

Most of the improvement in the public finances is expected to come from the revenue side. In particular, the authorities envisage reducing the primary deficit mainly through a gradual increase in the tax revenue ratio (from 16.2 to 18.8 percent of GDP) by 2012. This is to be achieved on the back of high economic growth and through amendments to the tax law that would (i) bring all direct taxes under a single code to facilitate voluntary compliance and (ii) minimize exemptions. Two large tax reforms are underway but they are expected to be broadly revenue neutral: a new Direct Tax Code is set to take effect by April 2011 (including the reduction in the CIT rate from 30 percent to 25 percent), and a revised Goods and Services Tax is being negotiated between the center and the states. An important expenditure-based element of fiscal consolidation is the partial liberalization of administered food prices effective June 25, 2010.

At the same time, the authorities plan to expand certain expenditure components as part of their "inclusive growth" strategy for 2007-12. The inclusive growth policies entail developing infrastructure and expanding access to health and education and food subsidy programs, especially in rural areas. Total investment in infrastructure will increase from 4.5 percent of GDP to 8.0 percent of GDP during 2007-12. The Right to Education Act was approved and the Food Security Bill is expected to be passed by parliament soon.

The principal challenge for pension and health care reforms in India involves expanding access, especially in rural areas. The New Pension System was established only in 2004 and was extended to the general public from May 2009. The National Rural Health Mission that aims to make health services accessible in rural areas was launched in 2005. The challenge is to expand pension and health coverage, but in a manner that does not generate fiscal imbalances as the systems mature.

Indonesia

The authorities' medium-term exit strategy is to gradually reduce the deficit to 1.2 percent of GDP and lower the public debt-to-GDP ratio to about 24 percent of GDP by 2014. This strategy, which implies a small reduction of the general government deficit (by 0.4 percentage point of GDP compared to 2009) and the debt ratio (by 4½ percentage points), is supported by a benign macroeconomic outlook, a track record of prudent fiscal management prior to the crisis and a relatively modest fiscal stimulus in 2009.

In the near term, the fiscal stance is likely to remain broadly neutral vis-à-vis 2009. The 2010 revised budget deficit target (2.1 percent of GDP) was modestly expansionary due mostly to the implementation of the second stage corporate tax cuts (0.5 percent of GDP); however, the government has just revised down its deficit estimate to 1½ percent of GDP, reflecting stronger revenue performance and slow execution of spending (including capital spending). The preliminary 2011 budget (released on August 17) indicates an overall deficit target of 1¾ percent of GDP, which implies a broadly neutral fiscal stance vis-à-vis 2009, but some modest withdrawal is likely if spending execution problems persist.

Beyond 2011, the authorities are planning for gradual fiscal consolidation, underpinned by revenue administration and structural reforms. A gradual deficit reduction is envisaged based on an increasing revenue-to-GDP ratio, underpinned by revenue-enhancing reforms (modernizing tax administration, enhancing tax collection) as well as efforts to increase oil and gas production. Structural measures have so far been limited to the electricity tariff hike (10 percent on average) implemented in July 2010, in an effort to curtail electricity subsidies. However, the fiscal impact is relatively small (not more than 0.1 percent of GDP).

Ireland

The Irish government plans to reduce the general government deficit to below 3 percent of GDP by end-2014. This is in line with the requirements under the Excessive Deficit Procedure of the European Union as laid out in Ireland's Stability Program. Adjustments designed to yield about 5 percentage points of GDP were already introduced between July 2008 and the Supplementary Budget of April 2009, the latter of which included multi-annual budgetary plans for the first time. The Budget 2010 of December 2009 added the adjustment of €4 billion (2.5 percent of GDP) for the government deficit to be stabilized at the 2009 level. The budgetary projections for 2011-14 include a future consolidation package, where additional adjustments of €3 billion are envisaged for 2011 and 2012. A number of policies have been identified for future consideration, including reforming the income tax and social security system, further public sector pension reform, and property taxation.

The adjustment plan includes both expenditure-reducing and revenue-enhancing measures, but is tilted towards the spending side. This is consistent with earlier Irish

experiences in successful consolidation. The main spending cuts affect the wage bill (general moratorium on recruitment and promotion, encouragement of early retirement) as well as pension outlays, introduce a range of efficiency measures across Departments and Agencies, minimize expenditure on consultancy, advertising and PR, and re-prioritize capital projects. On the revenue side, measures include the introduction of an income levy (wider coverage than income tax) and carbon tax, as well as an increase in social security-related contributions.

In order to address the long-term fiscal pressures from ageing, a range of measures has been put in place. These include the introduction of a public service pension-related deduction in March 2009 letting public servants make a greater contribution to the funds, raising the minimum pension age (from 60 to 65 years) for new public servants, and revising the tax system to encourage long-term savings and to promote increased employment.

Institutional fiscal reforms have also been undertaken. A unified budgeting system, whereby spending and revenue decisions are announced together on budget day, was established. Annual output statements were introduced to provide the link between performance and resource allocation. Moreover, the appraisal and management of capital projects, public procurement and value for money requirements were improved.

Italy

The fiscal adjustment package approved by parliament in July targets a below-3 percent of GDP deficit by 2012, in line with the requirements of the Stability and Growth Pact. Under the consolidation plan, the overall deficit is projected to decline from 5 percent of GDP in 2010 to 3.9 percent of GDP in 2011 and 2.7 percent of GDP in 2012. The adjustment is focused on 2011 and 2012, with the cumulative net fiscal impact of policy measures through 2011, 2012, and 2013 estimated at ¾, 1½, and 1.4 percent of GDP (based on the authorities‘ GDP), respectively. The plan, however, does not include a target beyond the adjustment horizon of 2010–13.

The planned consolidation is mostly expenditure-based, with the adjustment burden shared between central and sub-national levels of government. Net expenditure measures average about two-thirds of the total net fiscal impact. About one-third of overall consolidation is expected to come from spending cuts at the sub-national level and close to 30 percent is to be derived mainly from restraints on public sector employment and wages as well as savings from pensions and other social transfers. In particular, by 2013, the public wage measures are projected to improve the fiscal balance by 0.2 percentage points of GDP, while the reduction in social transfers (pensions, pharmaceutical spending, severance pay) are expected to contribute 0.3 percentage points of GDP to the consolidation. The remaining adjustment is expected to be generated mainly by revenue administration measures intended to fight tax evasion.

No major fiscal structural reforms are included in the package, but earlier reforms of fiscal federalism and public financial management are proceeding and pension reforms continue. On the latter, the plan includes some welcome modifications in the pension system aiming at further increasing the retirement age (accelerating the increase in the retirement age for female public sector employees, extending so-called ―exit windows” that affect the effective retirement age, and applying a three-year indexation mechanism linking the age retirement prerequisites to changes in life expectancy starting from 2015). Key aspects of the package are also related to the ongoing reforms of fiscal federalism (cuts in sub-national transfers) and public finance management (modifications in budgeting procedures), but these reforms are yet at their initial stages of implementation.

Japan

The Japanese government plans to halve its primary deficit to 3.2 percent of GDP by FY 2015, to achieve a primary surplus by FY2020, and to engineer a steady reduction in the debt-to-GDP ratio from FY2021. A Fiscal Management Strategy (FMS) was announced in June 2010 as a part of efforts to pursue a stronger economy and sound public finances. It lays out the basic principles for fiscal management and a medium-term fiscal consolidation path. It includes a ―pay-as-you-go” rule that requires any spending increase or revenue reduction to be offset by spending cuts or revenue increases elsewhere; regular expenditure reviews in all areas including special accounts to gain efficiency and reorganize the budget; and fiscal consolidation at the general government level with cooperation from local governments. To achieve the fiscal targets, a medium-term fiscal framework (MTFF), which will start from FY2011 and be revised annually based on prudent economic assumptions, was also introduced. In the meantime, prompted by the recent moderating recovery and appreciation of the yen amid the on-going deflation, in August the government announced an extension of several fiscal stimulus measures including incentives for energy efficient products and employment support, which will be funded by contingency reserves (about 0.2 percent of GDP) in the FY2010 budget. Moreover, on October 8, the cabinet approved a new stimulus package that could amount to 1 percent of GDP and would largely be financed by higher-than-budgeted tax revenue.

Adjustment will build on both expenditure-reducing and revenue-enhancing measures that still have to be specified. The FMS imposes an ―overall expenditure limit” under which the amount of general account expenditure (excluding debt repayment and interest payments) in FY2011-13 will not exceed that of the previous fiscal year (about 15 percent of GDP in FY2010), unless new and permanent tax revenues are secured. Also, new government bond issuance in FY2011 will be capped at its FY2010 level (about 9 percent of GDP). However, other specific spending reduction measures (for example, types of spending to be cut) were not included in the FMS. On the revenue side, specific and detailed measures are scheduled to be announced later.

A comprehensive tax reform and entitlement program reforms are recognized as necessary to bring public debt to more sustainable levels and to address long-term fiscal pressures. A range of policy options for future consideration have been identified, including a consumption tax hike, corporate tax reform, an income cap on social transfers and an increase in the statutory retirement age. However, detailed plans still have to be announced.

Annual budget formulation will be based on the MTFF under which budget requests from ministers must be made within the limits allocated to each ministry. The MTFF will be revised each year to cover a three year period, and progress towards the targets will be examined and made public. Also, progress is being made towards introducing a single numbering system for taxpayers and social security.

Korea

Korea plans to nearly eliminate its small overall budget deficit by 2013, starting with measures in 2010. In 2010, the government‘s budget envisages a withdrawal of fiscal stimulus of 2 percent of GDP, which would bring the central government budget back into balance. Most of the adjustment is on the expenditure side. Over the medium term, the authorities, based on the 2010-13 budget, envisage a continued strengthening in the central government balance to a surplus of 1.9 percent of GDP by 2013, largely through expenditure reduction. The consolidated fiscal deficit will decline correspondingly from 2.7 percent of GDP to 0.5 percent of GDP in the same period, which would allow the general government gross debt to remain below 35 percent of GDP. With the low level of public debt and a history of fiscal prudence, fiscal sustainability is not a major concern for Korea. Fiscal reforms and medium term adjustments have rather been motivated by the goal to ―retain room for counter-cyclical fiscal policies and accommodate the fiscal costs of aging.”

Adjustments will be made mostly through spending cuts. Expenditure measures include the non-renewal of temporary stimulus measures, although social spending outlays to protect the most vulnerable groups will not be cut. The medium-term spending measures include suspension or downsizing of temporary projects, expansion of PPPs and improved prioritization of public investment. Further, better performance management is expected to curb spending across all areas of government, including social welfare, health, education and labor. The impact of revenue measures is estimated at 0.3 percent of GDP (net) in 2010, through higher taxation of financial transactions and broadening the tax base. Tax measures will continue over the medium term, yielding 0.3 percent of GDP in 2011 and a further 0.1 percent of GDP in 2012. The measures include the elimination of extensive allowances and incentives for CIT and PIT, increasing social security contributions and environmental taxes, while making space for further rate cuts (such as a 2 percentage point cut for the highest CIT and PIT brackets).

The authorities plan to increase the efficiency of the fiscal system with a view to strengthening the credibility of fiscal policies. In preparing the National Fiscal Management Plan of 2010-14, the authorities will also devise measures to improve the fiscal management system. For more efficient distribution of funds, a tax expenditure budget, which will be submitted to the National Assembly in October 2010, will be introduced for the first time. Also, the Government plans to work on an inter-generational accounting to evaluate the longer-term fiscal burden that will carry over to the next generation and prepare an appropriate response. However, despite the looming demographic pressures that Korea is facing, the medium-term plans do not include any pension and health care reform plans.

Latvia

Latvia's adjustment targets have been set under its EC/IMF-supported program (until 2011) and its Convergence Program until 2012. The program sets targets that are in line with the EC-approved adjustment path towards euro adoption, which requires fiscal deficits below 8.5, 6, and 3 percent of GDP in 2010, 2011 and 2012, respectively. The authorities are in the process of preparing a menu of possible concrete consolidation measures.

Since the beginning of the fiscal adjustment in 2009, measures of around 13 percent of GDP have been taken, most of them (10 percent of GDP) on the spending side. The main spending measures include civil service salary cuts averaging 30 percent, which will combine with workforce reductions to save about 4 percent of GDP. Across-the-board cuts in spending on goods and services and investment saved about 5 percent of GDP. Revenue measures include increases in the value-added and personal income tax rates and many excises. Tax bases were also broadened by including capital income and fringe benefits. A decision on measures going forward is still outstanding. The introduction of a social safety net (higher guaranteed minimum income, coverage of health co-payments for poor, public works program) from late 2009 onwards helped alleviate hardship during the severe economic crisis.

Structural reforms are occurring in the health and education sectors and the fiscal framework. Reforms in the health sector aim to reduce hospitalization by improving access to cheaper outpatient care. In the education sector money now follows students and unusually high teacher-student ratios have been reduced closer to European averages. Going forward, reforms are likely to be aimed at improving or maintaining quality, rather than including further spending cuts. So far there was limited permanent structural welfare reform (for example, reduction of sick benefits), but a recent (nonbinding) strategy paper suggests minor reforms to old-age pensions (an increase in the retirement age, abolition of supplementary payments to pensioners). A fiscal responsibility law is under preparation to anchor fiscal policy following EC/IMF-supported program completion.

Lithuania

Lithuania's short-term objective is to reduce the general government deficit below 3 percent of GDP by 2012. This objective is clearly outlined in the Convergence Program approved in February 2010 in order to comply with the requirements under the excessive deficit procedure (EDP). In the medium term, the authorities aim for a structural surplus on the order of 0.5 percent of GDP. A fiscal consolidation of just over 7 percentage points of GDP was implemented in 2009, prompted by market pressures in addition to EDP requirements. The adjustment needed to reach the 3 percent deficit target is expected to be equally spread across 2011-12.

Adjustment has thus far been heavily expenditure based. To date, only about 15 percent of the total adjustment has fallen on revenues. Measures approved within the 2010 budget have sought to reduce the public sector wage bill, lower the ballooning deficit of the Social Security Funds through cuts in pensions, parental and unemployment benefits, and curtail spending on social assistance to eliminate payments duplicating insurance (child benefits, state pensions). Measures announced for 2011 go a long way towards making permanent past temporary cuts in wages, pensions and sickness benefits, and extending reduced transfers to the funded pension scheme. Effective July 1, 2011 parental benefits will be decisively reformed. While the Convergence Plan foresees the development of guidelines for the introduction of a residential property tax, currently the only tax measure announced for 2011 is an increase in diesel excises.

Structural and institutional reforms will have an important role in ensuring the medium- and long-term sustainability of the public finances. Health care reform to strengthen regulation of pharmaceutical prices, restructure services, and consolidate medical institutions started in 2010 and is expected to be carried out over five years. This is closely related to the ongoing public administration reform that aims to consolidate county administrations. Education reform that started in 2009 introduced more competitive funding practices for higher education and research. Comprehensive social security reform is currently under discussion to ensure the long-term sustainability of social insurance. A new deficit rule is under preparation in the context of the medium-term budgeting framework, though it is expected to take effect only after the EDP objectives have been achieved.

Mexico

With the 2010 budget, the authorities also announced their medium-term plan to bring the traditional fiscal balance back to zero by 2012. In 2010, the Mexican authorities started a process of fiscal consolidation, while trying to mitigate the impact of the fiscal withdrawal on the economy, using a two-pronged strategy. First, the 2010 budget included a tax package raising about 1 percent of GDP to offset the structural deterioration in the revenue position as oil revenue as a share GDP declined. Second, the budget invoked, for the

first time, the exceptional circumstances clause allowing for a temporary deficit under the fiscal rule‘s definition of traditional balance in 2010 and 2011. As a result, while the traditional deficit expanded, the augmented fiscal deficit would shrink to 3.6 percent of GDP in 2010. This implies a fiscal withdrawal of about 2 percent of GDP. Over the medium term, the authorities plan to reach a balanced traditional fiscal budget by 2012 (-0.7 percent of GDP in 2010, -0.3 percent of GDP in 2011 and balanced budget in 2012), reduce gradually the gross financial requirements of the public sector, and bring the debt ratio back on a declining trend by 2011.

In 2010, the adjustment included revenue and expenditure measures while for the medium term no specific measures have been announced. The tax package included permanent increases in the VAT and excises rates, expansion of the CIT base, and temporary increases in the PIT and CIT rates. Measures also included restraint in wage and administrative expenditures. No measure has been announced yet to deliver the further adjustment planned for 2011 and 2012. Also, no entitlement reform has taken place after the pension reform enacted in 2008.

The authorities modified their fiscal rules framework to gain flexibility in their consolidation efforts. With the 2010 budget, the authorities temporarily removed caps on the accumulation of revenue windfalls in the oil stabilization funds, allowing the building up of buffers previously used to finance the 2009 budget.

Portugal

The government announced its initial fiscal consolidation strategy in its Stability Program in March 2010 and in May added measures in light of market pressures.[37] Faced with a deteriorated external environment and higher cost of funding, the authorities announced additional consolidation measures in May, which were incorporated into the mid-year budget review in July. The authorities also decided to front load in 2010 some of the measures originally envisaged for 2011. The objective is to further reduce the deficit-to-GDP ratio to 7.3 percent (from the original 8.3 percent) in 2010 and 4.6 percent (from the original 6.6 percent) in 2011. As a result, the new target is to reduce the deficit to 3 percent of GDP and stabilize debt at 85.9 percent of GDP by 2012.

Fiscal consolidation relies both on revenue and expenditure measures but becomes more expenditure-intensive in 2012 and 2013. Revenue measures include a 1 percentage

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[37] In September, the government announced a new set of measures due to further market pressures and a weak fiscal performance in 2010. These additional measures would help reach the same announced deficit targets, and should be approved by the Parliament as part of the 2011 budget proposal. This summary only covers the measures already approved in the mid-year budget review.

point increase for all VAT rates (standard rate increased from 20 to 21 percent); a 2.5 percentage point increase on the corporate income tax rate for corporations with taxable profits above €2 million; 1 and 1.5 percentage point increases in personal income tax (PIT) rates on salaries between 1-5 minimum wages, and above 5 minimum wages, respectively; a new 45 percent bracket for the PIT; a reduction in tax benefits; and the broadening of the social security contribution base. The main expenditure measures include a wage bill reduction in order to reach 10 percent of GDP by 2013; reduction in transfers to state-owned enterprises and local governments; cuts in capital expenditures and intermediate consumption; and rationalization of social benefits (including means testing). These measures will be in place through 2013 and their estimated cumulative impact is 5.5 percent of GDP (2.1 percent of GDP revenue measures and 3.4 percent of GDP expenditure measures).

The government is committed to deliver on the ongoing structural reform agenda from 2006 and envisages reforms to address some institutional budgetary weaknesses. The main structural reforms in the agenda are improving revenue and social security administration (especially to combat fraud continuing with the privatization plans) and rationalizing the civil service. Moreover, the authorities envisage tackling shortcomings in fiscal institutional arrangements by implementing a medium-term expenditure framework and a performance-based approach to budgeting and management.

Russia

In July 2010, the authorities announced a new medium-term consolidation strategy that sets the target of halving the budget deficit by 2013. The corresponding adjustment in the nonoil deficit will be 4 percent of GDP over three years. The announced plan is moderately frontloaded: half of the adjustment is planned for 2011 with the rest equally divided over the next two years. The previously announced target of balancing the budget by 2014 has been shifted to 2015. Its low level of public debt together with the Reserve Fund accumulated from oil revenues shielded Russia from market financing pressures. At the same time, the large size of the fiscal stimulus and its bias toward permanent measures require an early start on consolidation as well as profound public sector reforms.

Adjustment is predominantly expenditure-based, though some tax increases are planned as well. According to the budget plans for 2011-13, the expenditure-to-GDP ratio will fall by 3.7 percentage points; however, the information on exact expenditure measures is not yet publicly available. Revenue measures include a gradual increase in gas and oil extraction taxes, excise taxes on tobacco and petrol in 2011-13, the introduction of export taxes on nickel and copper, and an increase in the social security tax in 2011. Total budget revenues as a share of GDP are projected to decline due to the falling growth in oil production in the coming years, but nonoil revenues are projected to increase by 0.2 percentage points of GDP. Almost 90 percent of the adjustment falls on the central

government; at the same time, regional governments will have to cut their deficits by more than 70 percent in three years. The recent increase in pensions is aimed at protecting the most vulnerable.

Reform plans in pension, health, and social transfers are well advanced, but implementation has stalled. The Minister of Finance has announced plans to reduce the number of government administration employees by 20 percent by 2013. There are plans to increase the retirement age, but socially-sensitive structural reforms could prove difficult to implement before the next presidential elections in 2012. As part of the financing strategy the government announced privatization plans with a revenue target of 1.6 percent of GDP over the next three years.

The authorities do not have plans to introduce new fiscal rules. Russia's budget code has a rule that limits the federal government nonoil deficit to 4.7 percent of GDP from 2013, but this deadline is likely to be extended to 2015. Staff's analysis suggests that the deficit limit is sustainable from a long-term intergenerational perspective.

Saudi Arabia

The authorities have established a medium-term target for expenditure. Fiscal policy will continue to be guided by a philosophy of saving sufficient oil wealth to enable countercyclical action and preserve intergenerational equity, while meeting the increasing demands on the budget as a result of demographic pressures. Saudi Arabia adopted the largest fiscal stimulus package as a percentage of GDP among G-20 countries. The centerpiece of the package was a $400 billion, five-year investment program, of which over one-half has already been spent. Total expenditure is expected to peak in 2010 at 40 percent of GDP and remain at historically elevated levels of about 37 percent of GDP over the medium term, driven by social sector and infrastructure spending—expenditure pre-crisis was about 30 percent of GDP. Nevertheless, total spending will be kept within limits that are in line with sustainability considerations, and the annual level of current expenditure will be adjusted to avoid the emergence of inflationary pressures. Capital expenditure will be guided by five-year development plans. Furthermore, the authorities plan to halve the gross debt-to-GDP ratio to less than 8 percent of GDP by 2014 and to build net assets back to 2009 levels (about 96 percent of GDP). As substantial oil revenue provides a ready source to finance higher spending, a greater concern is whether the fiscal stance would support the objective of reducing inflation to 3 percent by 2013.

Nevertheless, measures are underway to control spending and increase revenues over the medium term. The authorities indicated that spending will be lowered over the medium term through the unwinding of the $400 billion spending program, privatization, and use of public-private partnerships (PPPs). While they do not review the productivity of each project, they do conduct an overall assessment of spending in the context of the five-year

development plan. The authorities also anticipate higher oil and non-oil revenue, owing to higher transfer rates of export revenues to the budget the modernization of revenue collections.

No major new structural and fiscal institutional reforms have been announced. Structural reforms over the medium term aim at increasing non-oil growth in a sustained fashion so as to generate employment opportunities for a rapidly growing labor force. Therefore, reforms are largely focused on improving the competitiveness of the Saudi labor force by improving education and training. Other reforms under consideration include the expansion of mandatory insurance for health, and a review of benefits and measures to improve the efficiency of the pension system. The effect of these measures has not been quantified.

South Africa

The authorities anticipate a gradual recovery from the extraordinary crisis-related weakening of the balance. The recovery is to come through cyclical improvements to revenues and expenditure restraint. They will continue with large scale infrastructure projects and address transportation and energy sector bottlenecks that were strongly undermining growth in the mid-2000s. The public sector borrowing requirement remains significantly higher than pre-crisis, largely due to the financing of state owned enterprises.

A combination of measures is envisaged. In the Budget 2010, the authorities introduced some revenue measures, including carbon emission taxes, raised fuel and alcohol excises and closed loopholes while improving administration. However, expansionary personal income tax measures largely offset these revenue gains. The authorities will also act to reduce contingent liabilities by issuing fewer guarantees and refinancing debt without such guarantees. However, this will be done considering the economic cycle and not to endanger the economic recovery.

No concrete steps are planned to address the imbalances in the social security system. Rather, the pension age for men is being reduced to bring it in line with the pension age for women (60 years).

The authorities are contemplating the reform of the medium-term fiscal framework. This could include the introduction of a fiscal rule and strengthening the use of cyclically adjusted indicators.

Spain

The government has announced a fiscal consolidation plan in order to reduce the deficit from 9.5 percent of GDP in 2009 to 3 percent of GDP by 2013. This target was originally spelled out in the March 2010 Stability Program. However, given the deterioration of the

external environment and higher cost of funding, the authorities announced additional measures in May in order to frontload the adjustment. The adjustment plan was estimated at 6.0 percent of GDP over 2010-13. As a result, the estimated deficit-to-GDP ratios will be further reduced to 9.3 percent (from the original 9.8 percent) in 2010 and 6.0 percent (from the original 7.5 percent) in 2011.

The fiscal consolidation relies more heavily on expenditure cuts (4.7 percent of GDP over 2010-13) than on revenue measures (1.3 percent of GDP). Main expenditure measures include reducing current and capital spending, restricting public sector hiring, cutting nominal public sector wages by 5 percent, suspending the annual pension increase in 2011, eliminating the birth allowance, and tightening the borrowing limits of the sub-national governments. Revenue measures include increasing the VAT rate by 2 percentage points from 16 percent to 18 percent; suspending the €400 PIT deduction, and increasing excise tax rates.

The Stability Program envisages a bold pension reform but ongoing political discussions have been inconclusive. The most concrete measure being discussed is a gradual increase in the retirement age from 65 to 67 years but more is needed, given that the Spanish costs associated with aging are above the EU average.

Spain's fiscal rule has been put into abeyance during the crisis. The exception and special circumstances clauses to its budget balance rule, adopted in 2003 and defining a budget target over the cycle have been activated during the current economic crisis. Moreover, the provision to present plans for correcting the target deviations within three years has been put on hold without a specific time frame. The IMF and the European Commission have pointed out the need for adopting a medium-term expenditure framework and a much stricter control of the sub-national public finances.

Turkey

Turkey's medium-term fiscal program (MTP), announced in September 2009, targets a phased improvement in fiscal balances over the 2010-12 period, which should be sufficient to return the debt-to-GDP ratio to a gradually declining path. Under the plan, which is predicated on macroeconomic forecasts that have not been updated for recent developments and does not account for better than expected 2009 fiscal outturn, the general government deficit would improve from more than 6 percent of GDP in 2010 to 3.5 percent of GDP in 2012 while gross government debt is forecast to peak at 49 percent of GDP in 2010, before declining to 47.8 percent of GDP by 2012. The authorities' revised MTP, which defines a new strategy and targets for 2011-13, was announced October 10, 2010, too late for inclusion in the analysis of this paper.

Just under two-thirds of the adjustment over the medium term is expected on the expenditure side. The authorities plan to reduce the expenditure-to-GDP ratio to around

37.8 percent of GDP in 2012 from an estimated 40.3 percent of GDP in 2010. Measures to support the back-loaded expenditure adjustment are not fully identified nor explicitly costed. Revenue adjustment was front-loaded and relied mostly on excise increases for fuel and tobacco. The central government is expected to bear almost all the adjustment burden.

The government foresees several fiscal structural reforms. The government plans to improve the effectiveness of public spending (through controlling health costs while maintaining standards, limiting the recruitment of new personnel at the central government level, and allocating resources to priority economic and social infrastructure). On the revenue side, measures aim at reducing the size of the informal economy through tax base broadening and strengthening tax administration, including through improved tax audits.

The authorities' adjustment strategy was to be supported by the implementation of a fiscal rule from 2011 onwards. The numerical fiscal rule was expected to provide a prudent anchor for fiscal policy while the accompanying improvements to the institutional framework were aimed at eliminating budget loopholes and tightening oversight of local government borrowing. However, approval of the legislation has been postponed indefinitely and no longer appears to be an immediate priority of the authorities.

United Kingdom

The United Kingdom adopted an ambitious multi-year plan in its June 2010 emergency budget that would accelerate and frontload the fiscal adjustment. The plan aims to balance the structural current budget and put the debt-to-GDP ratio on a declining path by 2014/15—one year earlier than in the previous government budget plan. The projected adjustment is relatively frontloaded, with discretionary tightening of 1¼ percentage points this fiscal year and 2½ percentage points next – about ½ percentage point more than the previous government's plan in each of the two years.

The composition of the adjustment is based on an expenditure and revenue mix. That said, the largest share of the adjustment (over 60 percent in the next four years) is to be carried out on the expenditure side. The June 2010 budget plans include spending reductions of £32 billion per year by 2014/15 (including £30 billion of current spending reductions and no further reductions in capital spending beyond those already announced; more details will be announced in the Spending Review in October 2010). As part of these spending reductions, the Budget announced £11 billion of welfare reform savings designed to reward work and protect the most vulnerable, including adopting the consumer prices index for the indexation of benefits, tax credits and public service pensions from April 2011. The Budget also announced a two-year freeze in public sector pay, except for those earning less than £21,000 a year. On the revenue side, £8 billion in net tax increases are budgeted, including from an increase in the main standard rate of VAT (to 20 percent) and the standard and higher rate of Insurance Premium Tax (IPT) (to 6 percent and 20 percent) from 2011. To help

protect those who are most vulnerable, child benefits will be frozen for three years to help fund significant increases in the Child Tax Credit. Pensions will be increased by the highest of earnings growth, price growth, or 2.5 percent from April 2011.

No significant specific structural reform has been announced. However, regarding pension tax relief, the Government is committed to protecting the public finances by introducing reforms that raise no less revenue than existing plans.

The two national fiscal rules—golden and sustainable investment rules—were suspended at end-2008 and a new Office for Budget Responsibility (OBR) created. To help guide the consolidation process, the government has announced a new fiscal mandate to (i) balance the cyclically-adjusted current budget and (ii) put the net public sector debt ratio on a downward path by 2015/16. Fiscal institutions have been further strengthened by the establishment of the OBR, whose mandate is to produce independent forecasts and provide objective analysis of fiscal policies. The OBR can support the much needed fiscal consolidation and play a key role in the resolution of the fiscal imbalances in the United Kingdom.

United States

The authorities' objective is to achieve a federal primary balance by 2015. This should stabilize the federal debt just above 70 percent of GDP. The authorities also aim to halve the overall federal deficit by 2012. The authorities' goal is to support the recovery in the short term while signaling clearly that the public finances are being put on a sustainable path in the long run. The draft FY2011 budget implied a sizable upfront adjustment of 2.2 percent of GDP in FY 2011, but the FY2011 Budget Mid-Session Review now points to a much slower pace of fiscal consolidation of ½ percent of GDP[38] in 2011 (due to lower-than-expected 2010 deficit and higher projected 2011-12 deficits).

The authorities' adjustment strategy includes both expenditure and revenue measures. The authorities are planning to introduce a three-year freeze of non-security discretionary spending, and are considering partial expiration at the end-2010 of the 2001 and 2003 tax cuts (for higher-income taxpayers). They also seek to broaden the corporate tax base, including by reforming the tax treatment of financial institutions and international corporations, while removing tax preferences for fossil fuel industries. Under these and other policies spelled out in the draft FY2011 budget, the authorities project a primary deficit of

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[38] These figures correspond to the federal primary deficit excluding financial sector support. They do not include the effect of the new stimulus package announced by the U.S. administration in mid-September. If all components of such a package were approved and implemented with delay, there would be almost no change in the fiscal deficit of the United States in 2011, with respect to the previous year.

1 percent of GDP by 2015. The newly established Fiscal Commission (see below) is to propose measures to reach the targeted primary balance by 2015. Meanwhile, fiscal consolidation continues at the state and local government level, in light of the diminishing federal aid, sluggish tax revenue, and balanced budget rules.

With the exception of health care reform, no fiscal structural reforms have been announced. The health care reform approved in March 2010 aims primarily at expanding the coverage, while the cost-reduction implications remain uncertain as they depend on future implementation of politically difficult cost containment policies. Further structural fiscal measures await the recommendations of the Fiscal Commission due in December 2010.

To strengthen fiscal adjustment, the authorities have created the Fiscal Commission. The Commission is tasked to propose measures to reduce the primary deficit to zero by 2015, and also consider options for medium-term and longer-term fiscal targets. On November 10, the co-chairs of the commission published their proposals, which aim to reduce the federal government deficit to 2.2 percent of GDP by 2015, stabilize the federal government debt-to-GDP ratio by 2014 and reduce it to 60 percent of GDP by 2024 and 40 percent by 2037. Proposed policies include expenditure cuts in discretionary (defense and non-defense) spending as well as tax and entitlement reforms. However, the need of a supermajority of 14 out of 18 members of the commission to pass recommendations could be a challenge. Also, Congress adopted a Pay-As-You-Go Act in February 2010, requiring offsetting measures to spending and revenue deficit-widening initiatives with some exemptions (for example, for the middle-class portion of the 2001 and 2003 personal income tax cuts, and—on a temporary basis—Medicare payments to physicians and reauthorization of Alternative Minimum Tax relief).

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