

15. Fiscal sustainability

Ensuring long-term fiscal sustainability requires that governments engage in continual strategic forecasting of future liabilities and macroeconomic trends in order to adapt financial planning accordingly. Indeed, increasing debt levels are harmful to governments' fiscal positions, and can cause a vicious cycle of growing debt and reduce potential for economic growth as funds are diverted away from productive investments. Currently however, many OECD countries face rising public debt-to-GDP ratios following the financial and economic crises, and there is a general consensus that the fiscal trajectory of most member countries is unsustainable. The costs associated with addressing the economic crisis, as well as projected increases in ageing-related spending, present difficult challenges for the sustainability of public finances.

The OECD has produced estimates of the surpluses that would be required to stabilise debt-to-GDP ratios by 2026. According to this model (described in Annex C), Ireland, the United Kingdom and Poland require a total increase from their respective 2010 primary underlying balances of over 7% of potential GDP in order to stabilise public debt in this time frame. The United States and Japan require 11% and 10% of potential GDP respectively to stabilise their debt-to-GDP ratios, however the required consolidation efforts are so large that they are not expected to reach this target by 2026 in this scenario. Conversely, the current states of public finances (e.g. fiscal balances and levels of debt) in Denmark, Hungary, Luxembourg, Norway, Sweden and Switzerland are such that these countries are not expected to require surpluses to achieve debt stabilisation.

This model's projections can be seen as the minimum effort required to improve the sustainability of public finances, since debt stabilisation may still coexist with undesirably high levels of debt in 2026. More stringent models examine the efforts needed to reduce debt to 60% of GDP and to pre-crisis (2007) levels by this same year. Ireland, the United States and Japan require the most effort to reduce debt to 2007 levels. In order to reduce debt to 60% of GDP (the maximum level of debt in the EU according to the Maastricht agreement), Japan currently faces the largest fiscal tightening efforts (31% of potential GDP).

Good strategic forecasting exercises should consider the costs associated with demographic changes; especially since most OECD member countries face growing budgetary pressures due to expected increases in ageing-related spending on health care, long-term care and pensions. On average, ageing-related public spending in OECD countries is expected to increase by nearly 3 percentage points of GDP between 2010 and 2025. In Luxembourg ageing-related spending is expected to increase by 5.7 percentage points of GDP over the next 15 years. However, relative to other OECD countries, Luxembourg is in a better fiscal position to respond to these growing demands and changing societal needs. Conversely, Ireland, Iceland and Spain face above average ageing-related expenditures but are considered to be in a weaker fiscal position currently.

Improving fiscal discipline will be key in stabilising finances, and many OECD member countries have adopted

fiscal rules which can require balanced budgets. Budget practices such as the use of medium-term expenditure frameworks that include targets or ceilings for spending can also help control excessive government spending.

Methodology and definitions

The data are drawn from the Preliminary Version of the *OECD Economic Outlook*, No. 89. The assumptions made to generate the primary balance required to stabilise the debt-to-GDP ratio can be found in the *OECD Economic Outlook*, No. 89, in Box 4.1 and Tables 4.1-4.4. See Annex C for further information on the model's assumptions.

The general government underlying balance is the cyclically adjusted balance excluding one-offs in revenues and spending, as well as interest payments. For most countries, data on gross debt used for the purpose of these calculations refer to the liabilities (short and long-term) in the general government as defined in the system of national accounts. This definition differs from the definition of debt under the Maastricht Treaty which is used to assess EU fiscal positions.

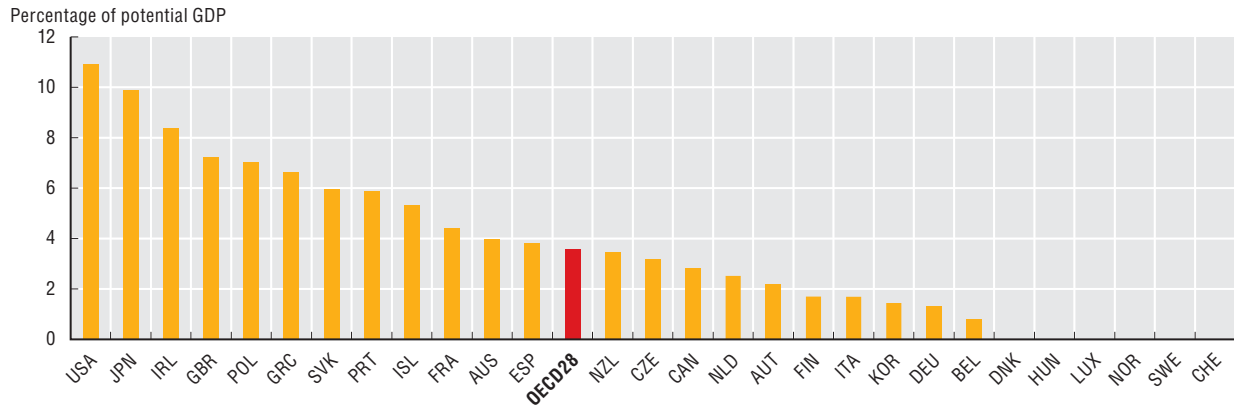
Further reading

- OECD (2010), *OECD Economic Outlook*, No. 88, OECD Publishing, Paris.
- OECD (2011), "Restoring Public Finances", Special Issue of the *OECD Journal on Budgeting*, Vol. 2011/2, OECD Publishing, Paris.
- Schick, A. (2010), "Post-Crisis Fiscal Rules: Stabilising Public Finance while Responding to Economic Aftershocks", *OECD Journal on Budgeting*, Vol. 2010/2, OECD Publishing, Paris.

Figure notes

- See *StatLink* for important country-specific notes. OECD averages are unweighted.
- Data on consolidation requirements are not available for Chile, Estonia, Israel, Mexico, Slovenia and Turkey. Data for ageing-related spending are not available for: Chile, Estonia, Israel and Slovenia.
- 15.1: For Japan and the United States, the required consolidation to stabilise debt is so large in 2012 that it is not achieved in the baseline scenario by 2026 given the assumed pace of consolidation. The estimated number of years of consolidation for these and other OECD countries is provided in Table 4.3 of the *OECD Economic Outlook*, No. 89.
- 15.2: Luxembourg, Sweden, Switzerland and Norway are not included in the figure because no consolidation efforts are needed in these countries to achieve either of the targets shown. In addition, in Denmark and Korea no consolidation is needed to achieve the 60% debt-to-GDP ratio by 2026. Countries that do not require consolidation efforts are included in the OECD28 average.

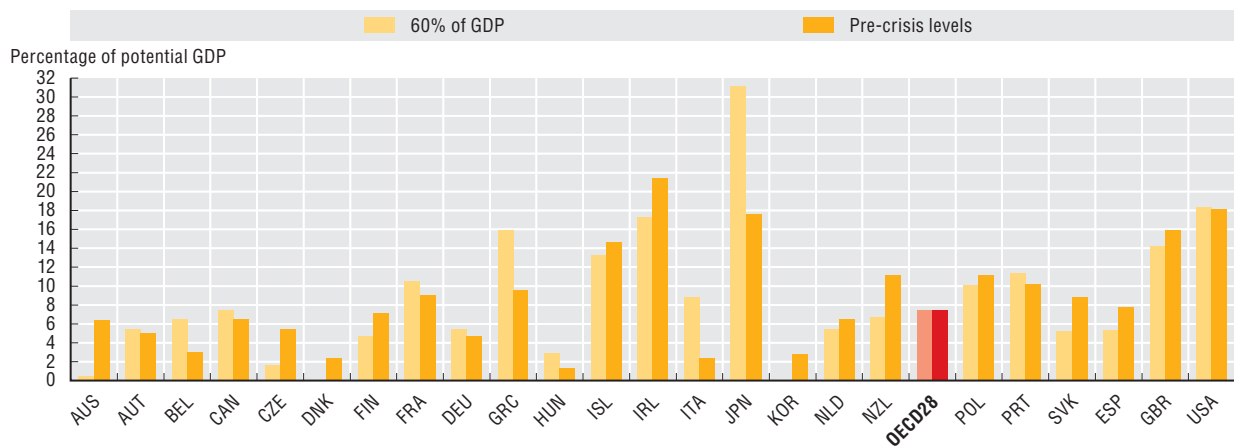
15.1 Total change required in underlying primary balance between 2010 and 2026 in order to stabilise gross public debt-to-GDP



Source: OECD calculations. OECD Economic Outlook, No. 89 (Preliminary Version), May 2011.

StatLink <http://dx.doi.org/10.1787/888932390348>

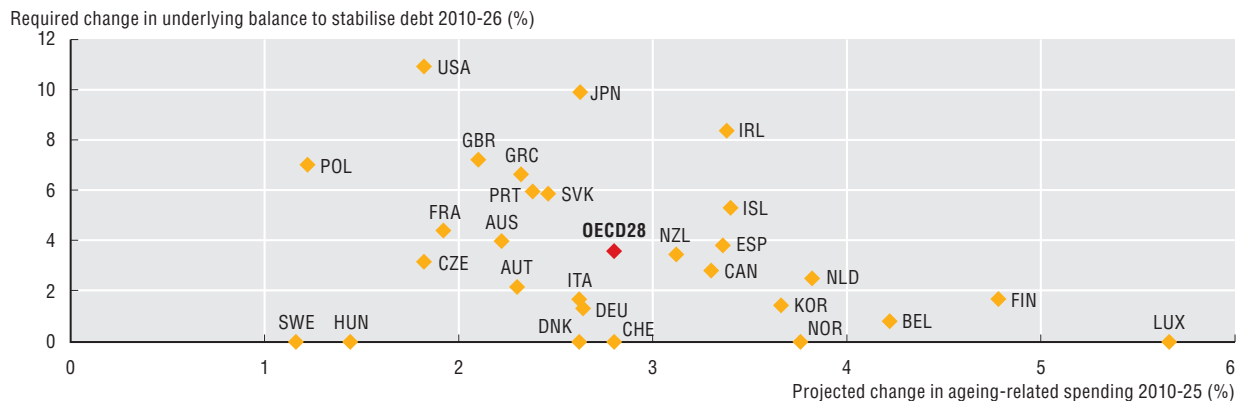
15.2 Total consolidation efforts required to reduce debt by 2026 to 60% of GDP and pre-crisis levels



Source: OECD calculations. OECD Economic Outlook, No. 89 (Preliminary Version), May 2011.

StatLink <http://dx.doi.org/10.1787/888932390367>

15.3 Fiscal consolidation requirements and projected change in ageing-related spending as a percentage of potential GDP



Source: OECD calculations. OECD Economic Outlook, No. 89 (Preliminary Version), May 2011.

StatLink <http://dx.doi.org/10.1787/888932390386>



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