



Lessons from Extreme Fiscal Adjustment

February 11, 2015

Adrian Fozzard

Practice Manager

Governance Global Practice

afozzard@worldbank.org

Extreme Fiscal Adjustment

Country	Period of Adjustment	General Govt Budget Balance (%)
Canada	1993-1998	-8.8
Finland	1993-2000	-16.0
Netherlands	1995-2000	-11.2
Sweden	1993-2000	-14.8
Thailand	1999-2003	-11.1
Turkey	2002-2006	-13.9
United Kingdom	1993-2000	-9.1

Extreme fiscal adjustment:
At least 8% point improvement in fiscal balance over 5 years

Source: WEO

Triggers

Canada	• MARKET – Mexican Peso crisis
Finland	• MARKET – Recession in 1990, collapse of FSU, trade shock, banking crisis, devaluation of currency
Netherlands	• POLITICAL – Campaign pledge to meet Maastricht deficit criteria
Sweden	• MARKET – Western recession in 1990, trade shock, markets forced Swedish Kroner to devalue
Thailand	• MARKET – Abandonment of dollar peg; instant bankruptcies in private and financial sector
Turkey	• MARKET – Major upheaval in 2001 affecting stock market, currency value, banking sector, and FDI
United Kingdom	• MARKET – Withdrawal from ERM reinforces need to control fiscal deficit



Setting Targets

	CAN	FIN	NL	SWE	THAI	TURK	UK
Goal	3%	70%	3%	0%	60%	6.5%	0%
Of	deficit	debt	deficit	deficit	debt	primary surplus	deficit
Within	3 years		4 years	4 years	1 year		4 years

- **Announcement has political cost:** short-term pain, for longer term benefits
- **Identify quick wins and early victories:** demonstrate can be achieved, build confidence and credibility, front load pain
- **Never just about stabilization:** would be easy if it were, need a clear hierarchy of objectives and longer-term perspective even in crisis mode
- **Never let a good crisis go to waste:** opportunity for fundamental structural - and sometimes ideological - reforms



Mobilizing Stakeholders

Broad Policy Agenda

- Canada – “A New Framework for Economic Policy”
- Turkey – “Turkish Transition to a Strong Economy Program”

Messaging - Fairness

- Sweden – Cut politicians salaries
- UK, Canada – Aggressive cuts administrative overheads



Convincing the Markets

- Complying with fiscal transparency standards
- Proactive reporting on forecasts and progress against targets

Managing political parties

- Parliamentary commissions and committees

Revenue Expenditure Mix

Canada	• 80 Expenditure / 20 Revenue
Finland	• Primarily expenditure
Netherlands	• Primarily expenditure
Sweden	• 53 Expenditure / 47 Revenue
Thailand	• Primarily expenditure
Turkey	• 70 Expenditure / 30 Revenue
United Kingdom	• 50 Expenditure / 50 Revenue

Expenditure Policies

Expenditure Policy Change	CAN	FIN	NL	SWE	THAI	TURK	UK
Across the board vs. targeted	Targeted	Targeted	Targeted	Targeted	Across the Board	Targeted	Targeted
Household transfers	Reduced		Reduced	Reduced	Reduced		Reduced
Intergovernmental transfers	Reduced	Adjusted	Reduced				Capped
Wage bill	Reduced	Reduced			Reduced	Reduced	Capped
Pensions	Yes	Yes					Yes
Privatization	Yes	Yes			Planned	Initiated	Yes/PPP



WORLD BANK GROUP

7

Revenue Policies

Revenue Policy Change	Canada	Finland	NL	Sweden	Thai	Turkey	UK
Consumption tax	X	X			X	X	X
Personal Income taxes				X		X	X
Corporate taxes	X	X		X		X	
One-off Temporary Measure					X		
Permanent measure	X	X		X		X	X



WORLD BANK GROUP

8

Budget Process Reforms

Measures	CAN	FIN	NL	SWE	THAI	TUR	UK
Ministerial / Technical Committees	X		X				X
Ministerial discretion / accountability	X	X	X	X	X	X	X
Spending reviews	X		X				X
Conservative macro forecasts	X	X	X	X	X		
Medium-term frameworks	X	X	X	X	X	X	X
Top-down budgeting				X			
Contingency reserve	X				X		X
Offset for new policy initiatives	X		X				X
Debt management					X	X	
Comprehensiveness of budget						X	
Revenue administration					X	X	

Wage Bill Savings

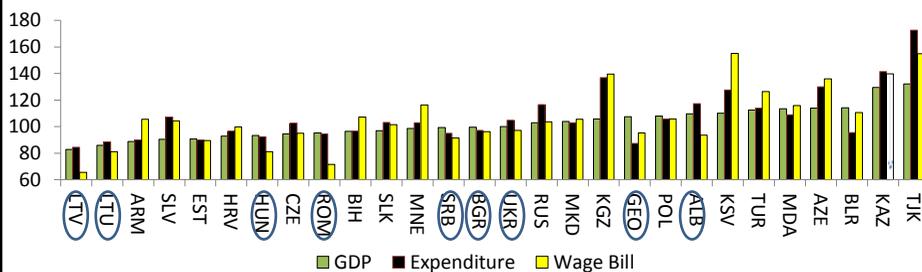
Staffing

- Downsizing, redundancies (Canada)
- Voluntary retirement (Netherlands)
- Hiring freezes (United Kingdom)
- Establishment caps

Pay

- Productivity pay (Sweden)
- Reduced benefits
- Salary freezes (United Kingdom)
- Salary cuts

Real Growth Index 2008-2011 (year 2008=100)



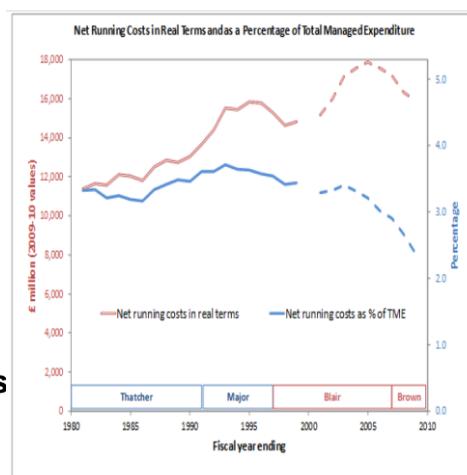
Avoid Temptation

- **Indecision:** analysis paralysis, cash rationing rather than budgeting,
- **Making the private sector pay:** delays in payments to suppliers, build up of payment arrears, script issues, debt restructuring and write-offs
- **Making local government pay, unfunded mandates:** shift responsibility for services to provinces and local authorities without funding (Netherlands, Canada)
- **Running down assets:** deferring maintenance, delaying investment in critical infrastructure



Changing the Role of the State

- Privatization
- Private sector delivery
- Decentralization
- Deregulation
- Cost recovery
- Contracting in / out
- Public Private Partnerships
- Discretionary v. Mandatory



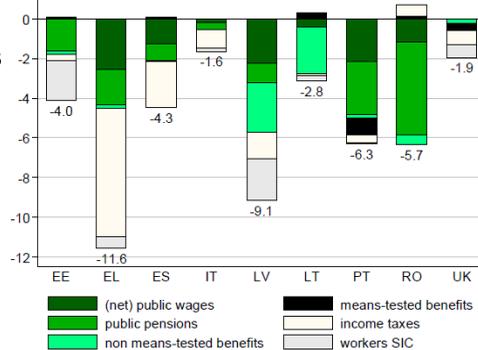
Household and Poverty Impacts

- **Improve targeting**

- Eliminate Product Subsidies
- Vulnerable groups
- Means-testing
- Conditional transfers
- Shift from benefits to active labor market policies

- **Assess cumulative impacts**

- Multiple household transfers
- Net-transfers including tax
- Household provide and access costs of services



Aggregate effect of simulated household income-based fiscal consolidation measures in place in 2012 as a percentage of total household disposable income, by type of policy



WORLD BANK GROUP

13

Competitiveness & Growth Impacts

- Deregulation of economy and privatization to create space and opportunities for private sector (Turkey)
- Active labor market policies, create human capital and strengthen labor supply (Finland)
- Targeting of benefits, subsidized childcare and strengthen incentives for labor market participation (Sweden)
- Prioritized public investments to promote exports and growth (Thailand)

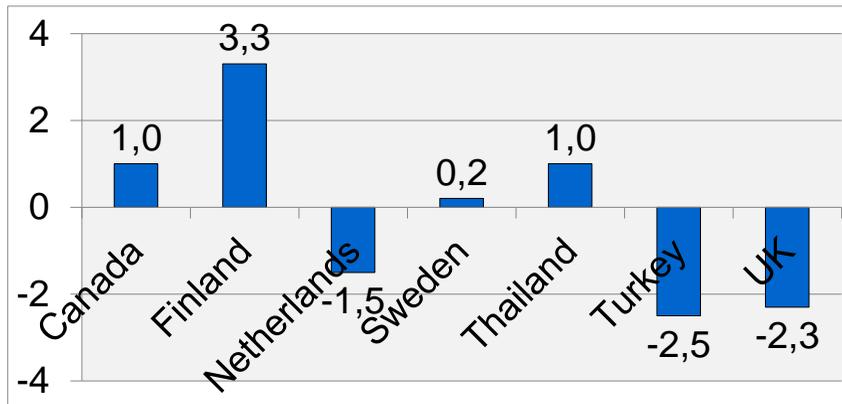


WORLD BANK GROUP

14

Sustainability of Adjustment

5 YEAR AVERAGE AFTER END OF ADJUSTMENT
General Government Balance % GDP



WORLD BANK GROUP

15

Preparing for Future Crises

- Strengthen macro-forecasting
- Strengthen policy analysis
- De-indexation (expenditures)
- Offset rules
- Sunset clauses
- Report on Fiscal Risks
- Strengthen Fiscal Transparency
- Fiscal Rules
- Fiscal Councils

Number of Years Complying with EMU
Legislation 2001-2010

	60 % Debt	3 % Deficit
Austria	0	7
Belgium	0	8
Cyprus	6	5
Estonia	10	10
Finland	10	10
France	2	4
Germany	1	4
Greece	0	0
Ireland	8	7
Italy	0	2
Luxembourg	10	10
Malta	0	3
Netherlands	8	7
Portugal	4	2
Slovak Republic	10	5
Slovenia	10	7
Spain	9	7

Source: EUROSTAT



WORLD BANK GROUP

16

Key Lessons from Success

- ✓ Sustained political leadership
- ✓ Build credibility, manage expectations
- ✓ Inform and empower decision makers in agencies
- ✓ Transparency fiscal planning and budget process
- ✓ Medium term perspective, strengthened forecasting
- ✓ Spending Review to inform decisions
- ✓ Adjustment both revenues and expenditures
- ✓ Expenditure cuts targeted, taking into account social and growth impacts

