



# **Fiscal Consolidation: IMF Experience and Policy Approaches**

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## **I. Why Undertake Fiscal Consolidations**

## **II. Big Picture Parameters**

## **III. Policy Composition**

## **IV. Budget Institutions**

# I. Why undertake fiscal consolidation?

## Various reasons

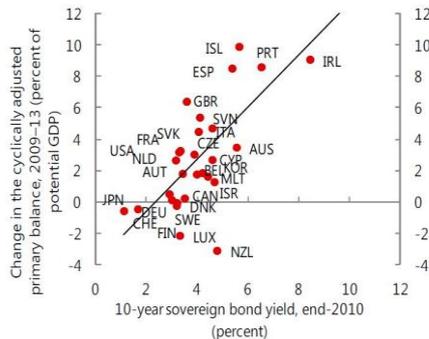


- **Immediate needs: ‘Consolidate or else’**
  - Externally imposed
  - Market funding/confidence issues
  - IMF supported programs
- **Debt sustainability: ‘I don’t like where this is going’**
  - Internally imposed
  - No immediate need, but recognize building pressures
- **Long-term Pressures: ‘A stitch in time saves nine’**
  - Domestic conversations
  - Demographic pressures

# Fiscal Consolidation Needs

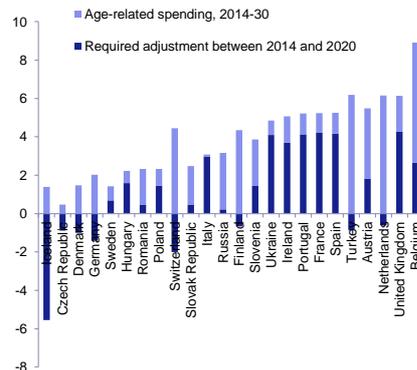


**Fiscal Adjustment and Market Conditions**



**Illustrative adjustment need to achieve long-term debt target in 2030**

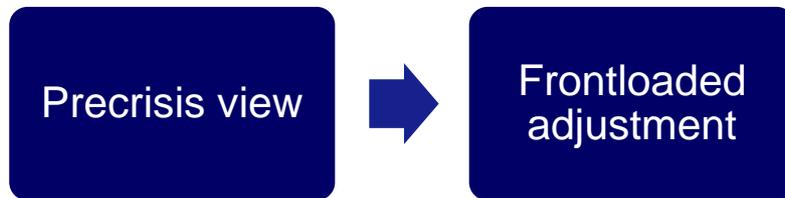
(Change in CAPB, percent of nominal GDP)



Sources: Bloomberg L.P., and IMF staff estimates and projections.

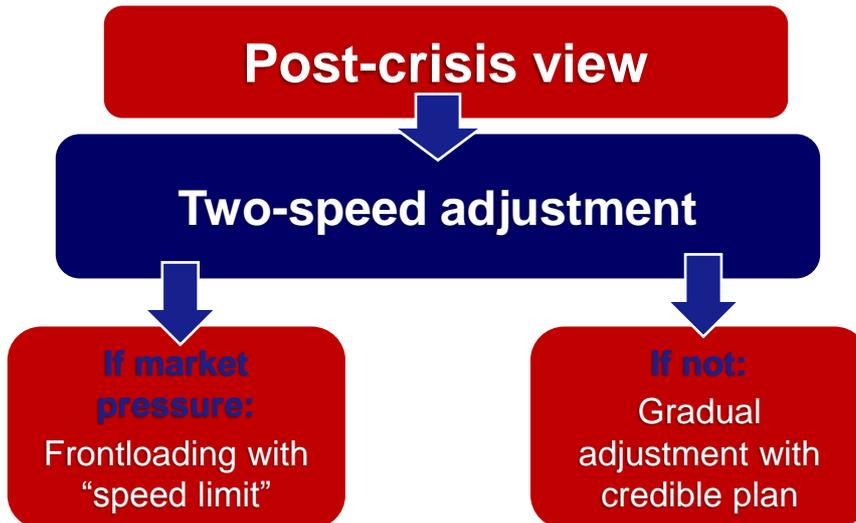
Notes: The relationship between the change in the cyclically adjusted primary balance (CAPB) and 10-year sovereign bond yield is statistically significant at the 95 percent confidence level.

## II. Big Picture Parameters Pace of Adjustment



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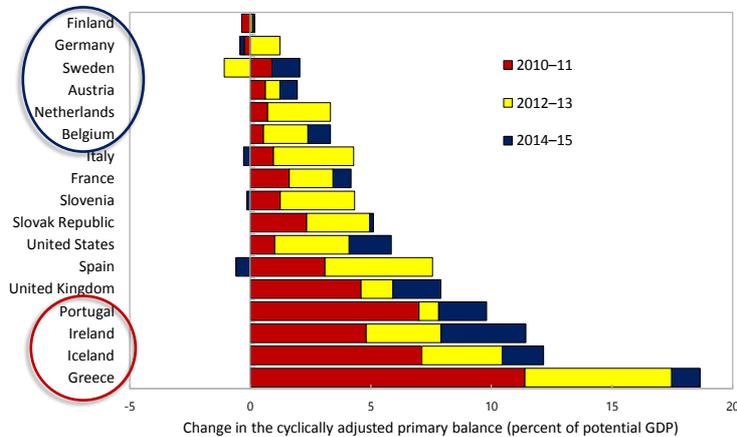


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## II. Big Picture Parameters Pace of Adjustment – Country Experience



Pace of Adjustment in Advanced Economies, 2010–15



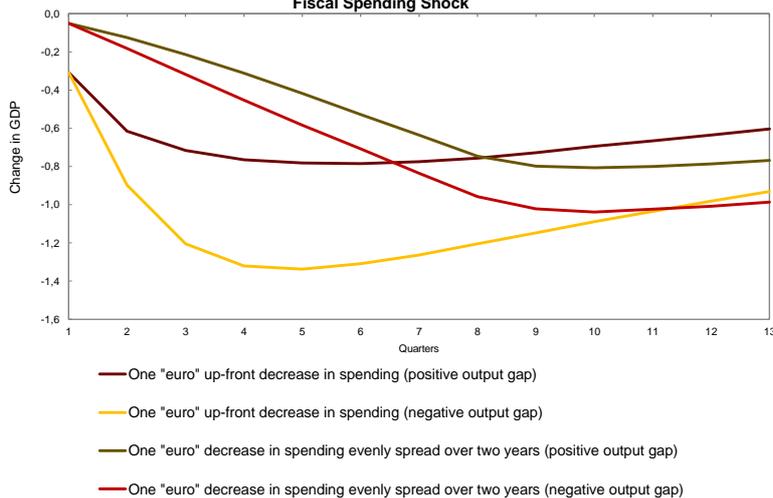
Source: IMF staff estimates; data from April 2013 *Fiscal Monitor*.

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## II. Big Picture Parameters What impact on growth – fiscal multipliers



G-7 Economies: Cumulative Impact on Output from a Negative Discretionary Fiscal Spending Shock



Sources: Baum et al. (2012) and IMF staff estimates.  
Note: The figure shows average multipliers for G7- countries with significant impact multipliers.

### III. Composition of Adjustment Policy mix



#### Pre-crisis view

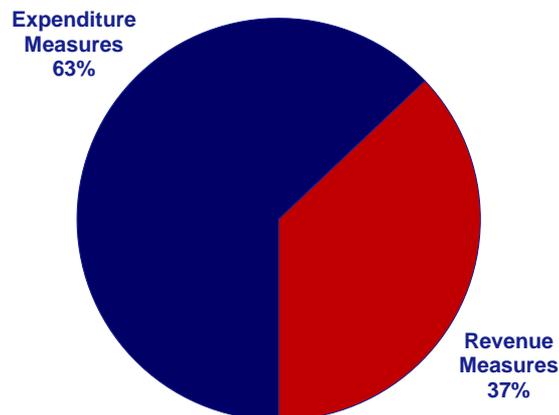
Expenditure-based  
adjustment good for growth

Higher taxation is  
distortionary

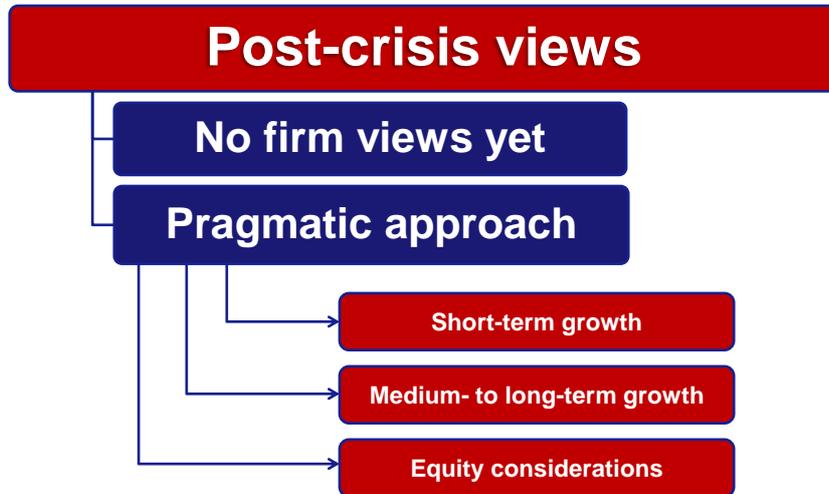
### III. Composition of Adjustment Pre-crisis adjustment plans



OECD Countries: Average Composition of Fiscal Adjustment,  
1978-2008  
(share of total in percent)

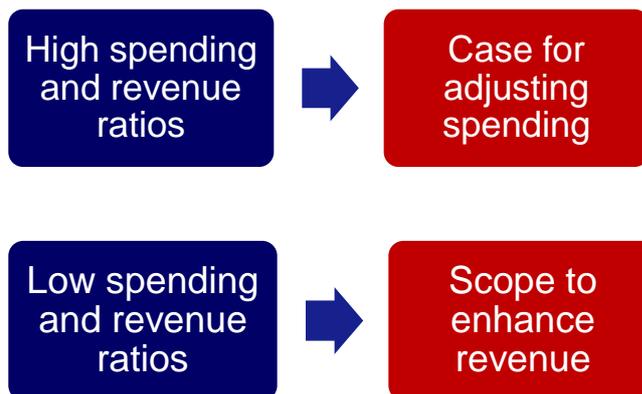


### III. Composition of Adjustment Policy mix



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### III. Composition of Adjustment Policy mix depends on starting point



### III. Composition of Adjustment Short term vs Structural Approach



- **Immediate needs: 'Need to do this fast'**
  - Wage and hiring freeze/cuts
  - Across the Board Cuts
  - Tax increases

} **ST savings, but quickly generate inefficiencies, pressures & arrears**
  
- **Debt sustainability: 'What are the lowest priority'**
  - Spending reviews
  - Indexation adjustments

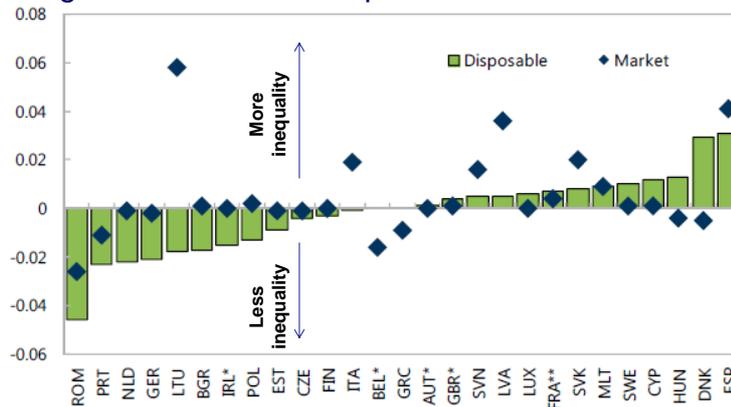
} **Better targeted, more sustainable, but take longer to impact**
  
- **Long-term Pressures: 'Deep seated reforms'**
  - Health and Retirement system
  - Energy Subsidies

} **True policy reform, often no direct savings, very difficult**

### III. Composition of Adjustment Fairness Matters



**Redistributive Effect of Fiscal Adjustments, 2007–2012**  
(Changes in market and disposable income Gini coefficients)



### III. Composition of Adjustment

#### Features of growth friendly tax measures



#### Tax reforms depend on the level and structure of the tax system:

- Base broadening is a key priority in most countries and could be combined with lower rates
- Many emerging and low-income economies have space to mobilize revenues in a growth-friendly manner to finance more productive spending
- Carbon taxes correct externalities and can raise up to 2½ percent of global GDP (*Getting Prices Right, 2014*), reducing other distorting taxes

### III. Composition of Adjustment

#### Features of growth friendly spending measures



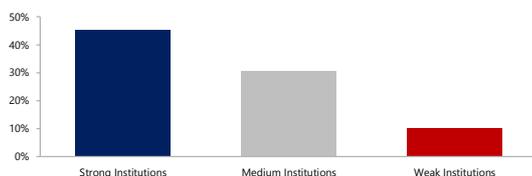
- Avoid across-the-board cuts: improve the efficiency of spending
- Generate fiscal space for more productive spending
- Realign incentives for consumers and producers
- Public infrastructure can crowd in investment and boost long-run productivity
- Critical factors are the investment process, such as project selection and implementation, and financing costs

## IV. Budget Institutions Overall Fiscal Performance



### Share of Adjustment Need Addressed

(2010-2015, Percent of Adjustment Need Identified)

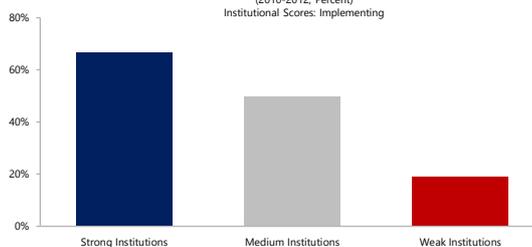


Countries with stronger institutions overall have addressed more of their adjustment need...

...while those with weak institutions have not tended to plan or deliver much

### Share of Planned Adjustment Delivered

(2010-2012, Percent)  
Institutional Scores: Implementing



Countries with stronger institutions were also better at sticking to their plans...

...while those with weaker institutions delivered less and had a more varied track record – some delivered while others missed by a wide margin

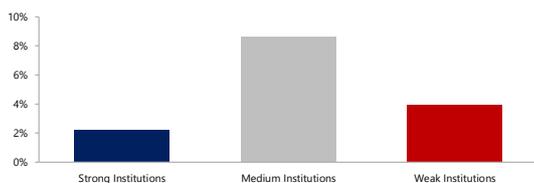
Source: MAP

## IV. Budget Institutions Understanding the Fiscal Challenge



### Absolute Revision to 2009 General Government Debt

(Percent of GDP)

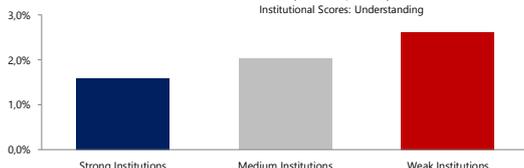


Relationship between strength of understanding institutions and revisions to fiscal data is complex...

### Average Absolute Year-Ahead GDP Forecast Error

(2004-2012, Percent)

Institutional Scores: Understanding

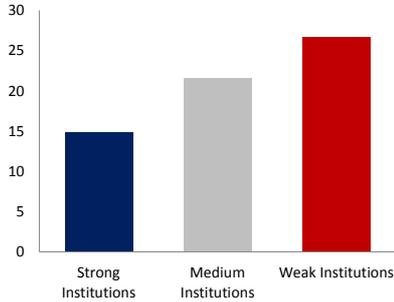


... But countries with stronger institutions for fiscal reporting, forecasting, and risk management saw smaller forecast errors impacting their plans

## IV. Budget Institutions Developing a Consolidation Plan

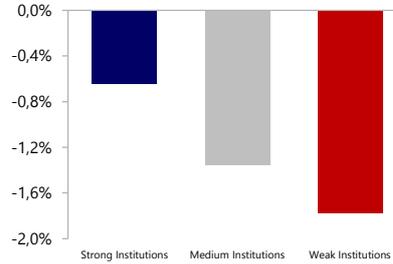


**Timeliness of Consolidation Plans\***  
(Months b/w Crisis & Plan Announcement)  
Institutional Scores: Planning



\*Months since January 2009.

**Protection of Capital Expenditure**  
(Change in Capital Expenditure as a Share of Total Expenditure, 2010-2012)  
Institutional Scores: Planning



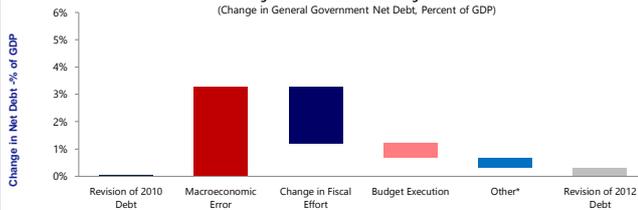
Having strong institutions seems to have led to earlier adjustment planning

Countries with stronger institutions protected capital investment during consolidation

## IV. Budget Institutions Response to Shocks

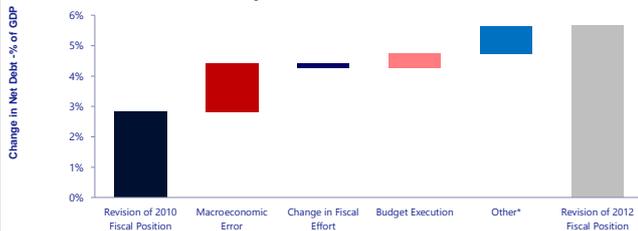


**a. Negative Macro Shock and Strong Institutions**  
(Change in General Government Net Debt, Percent of GDP)



Many adjustment plans were hit by macro shocks...  
...but countries with stronger institutions compensated with additional fiscal effort...  
... and under-execution of approved budgets...

**B. Negative Macro Shock and Weak Institutions**  
(Change in General Government Net Debt, Percent of GDP)



...while countries with weaker institutions were hit by revisions to their starting debt levels and macro shocks...  
...but failed to compensate with additional fiscal effort...  
... and overspent against approved budgets