

Reforming Public Expenditure in Industrialised Countries: Are There Trade-Offs?

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Outline

- Historic trends and outlook
- Spending trends over the past two decades
- Costs and benefits of expenditure reform
- Conclusion

I. Historic trends and outlook

- Strong expenditure growth due to welfare state expansion
- Earlier book found: Few gains of spending above 30-35% of GDP
- Prediction of strong spending decline
 - Change in ideas
 - More open and efficient markets
 - Costs of large bureaucracies, overuse, poor targeting, high taxes, deficit financing

II. Spending trends over the past two decades

- Average aggregate little changed (45-46% of GDP)
- But: dispersion reduced
- Inverted U-shape: average maximum over 50% of GDP

- Six countries (out of 22) reduced spending > 10% of GDP
- Six countries reduced > 5% of GDP
- Start of expenditure reduction=reform start

Most ambitious reformers

Country	Change in (G)/GDP	Year Peak Level Reached
Ireland	-16.4	1982
New Zealand	-14.9	1985
Canada	-11.4	1992
Netherlands	-11.2	1983
Belgium	-10.5	1983
Finland	-10.3	1993

Reform timing and ambition

- Two waves:
 - Early reformers: early to mid 1980s
 - Late reformers: early to mid 1990s
- Reform ambition differs
 - ambitious,
 - timid
 - non-reformers
- => 5 country groups

Five country groups

Categories	Countries
Ambitious and early reformers	Belgium, Ireland, Netherlands, New Zealand
Ambitious and late reformers	Austria, Canada, Finland, Norway, Spain, Sweden
“Timid” and early reformers	Australia, Luxembourg, United Kingdom
“Timid” and late reformers	Denmark, France, Germany, Italy, Switzerland, US
Non reformers	Greece, Japan, Portugal

Expenditure developments, past 20 years

	1982 or nearest	Maximum public expenditure ratio	2002 or nearest	Change Maximum-2002
Average	46.5	51.6	45.0	-6.6
Euro zone	47.2	53.7	46.7	-7.0
Ambitious reformers, early	56.4	56.5	43.3	-13.2
Ambitious reformers, late	47.1	56.7	48.1	-8.6
Timid reformers, early	44.1	45.0	40.3	-4.7
Timid reformers, late	45.5	49.4	45.7	-3.7
Non reformers	36.1	45.8	44.2	-1.6
Standard deviation	9.2	8.4	7.1	

Source: EU Commission, AMECO

Total expenditure: 1982, year of maximum spending ratio, 2002

Percent of GDP

	1982 or nearest	Maximum public expenditure ratio	2002 or nearest
	(1)	(2)	(3)
Australia	38.1	40.2 (1985)	35.6
Austria	49.0	57.3 (1995)	51.3
Belgium	60.8	61.0 (1983)	50.5
Canada	46.5	52.8 (1992)	41.4
Denmark	57.8	60.7 (1994)	55.8
Finland	41.3	60.4 (1993)	50.1
France	49.8	55.5 (1996)	53.6
Germany	48.1	50.3 (1996)	48.5
Greece	35.4	51.0 (1995)	46.8
Ireland	49.8	49.8 (1982)	33.5
Italy	48.3	57.1 (1993)	48.0
Japan	32.9	40.0 (1998)	39.8
Luxembourg	49.5	49.5 (1982)	44.3
Netherlands	58.6	58.7 (1983)	47.5
New Zealand	56.5	56.5 (1985)	41.6
Norway	45.6	54.1 (1994)	47.5
Portugal	40.0	46.3 (2001)	46.0
Spain	35.9	47.6 (1993)	39.9
Sweden	64.3	68.0 (1993)	58.3
Switzerland	32.8	35.7 (1998)	34.3
United Kingdom	44.8	45.4 (1984)	41.1
United States	36.2	37.2 (1992)	34.1

Stylised facts about expenditure developments

- Average decline: 6.6% of GDP (7.0 in euro area)
- Decline always started in downturn
- One third interest payments
- One third transfers and subsidies
- Ambitious reformers cut transfers and subsidies, not productive spending

III. Cost and benefits of public expenditure reform: fiscal performance

- Ambitious reformers consolidate successfully and cut taxes

<u>Post-reform change in:</u>	<u>Fiscal balance</u>	<u>Revenue</u>	<u>Public debt</u>
Ambitious reformers, early	7.6	-5.7	-30.0
Ambitious reformers, late	6.1	-2.5	-8.0
Timid reformers, early	2.9	-1.8	-7.6
Timid reformers, late	2.9	-0.8	-4.0

- Timid and non-reformers with largest imbalances

a. Fiscal balances, 5-year averages

	First reform wave		Second reform wave		Change since reform
	1983-87	1988-92	1993-97	1998-2002	
Average, all countries	-3.8	-2.9	-3.3	0.2	
Euro area	-4.9	-3.9	-4.1	-0.5	
Ambitious reformers, early	-7.0	-4.2	-1.5	0.6	7.6
Ambitious reformers, late	-1.5	-1.6	-3.6	2.5	6.1
Timid reformers, early	-1.1	-0.7	-1.9	1.8	2.9
Timid reformers, late	-4.5	-3.5	-3.7	-0.8	2.9
Non reformers	-6.1	-4.9	-5.9	-4.8	

Fiscal performance: debt

- Reform timing and ambition determine debt path

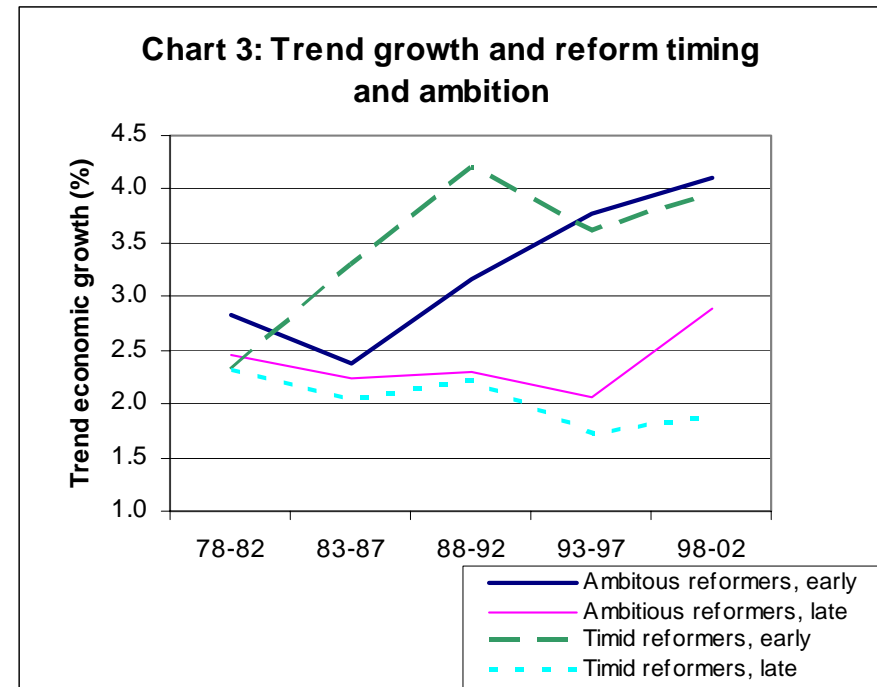
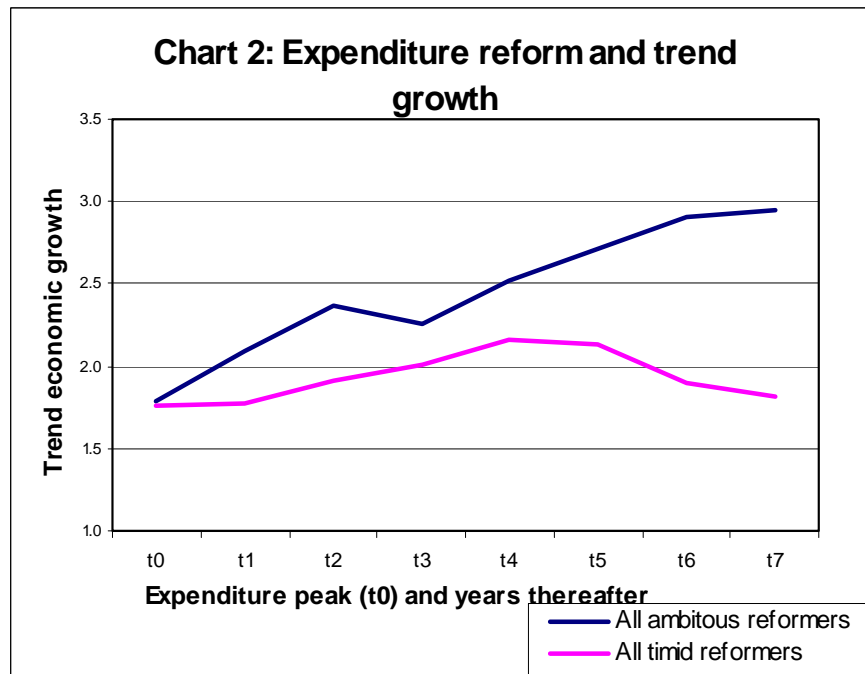
b. Gross public debt, 5-year averages

	First reform wave		Second reform wave		Change since reform
	1983-87	1988-92	1993-97	1998-2002	
Average, all countries	55.9	58.2	68.5	62.1	
Euro area	56.1	62.2	72.8	65.5	
Ambitious reformers, early	91.1	91.8	81.9	61.1	-30.0
Ambitious reformers, late	47.3	50.1	68.8	60.8	-8.0
Timid reformers, early	28.8	22.6	29.4	21.1	-7.6
Timid reformers, late	52.5	56.6	70.1	66.1	-4.0
Non reformers	60.4	68.3	86.0	99.4	

Source: EU Commission, AMECO

Economic performance: growth

- Expenditure decline starts in downturn
- Recovery of sustained growth takes time and is correlated with reform ambition



Economic performance: employment

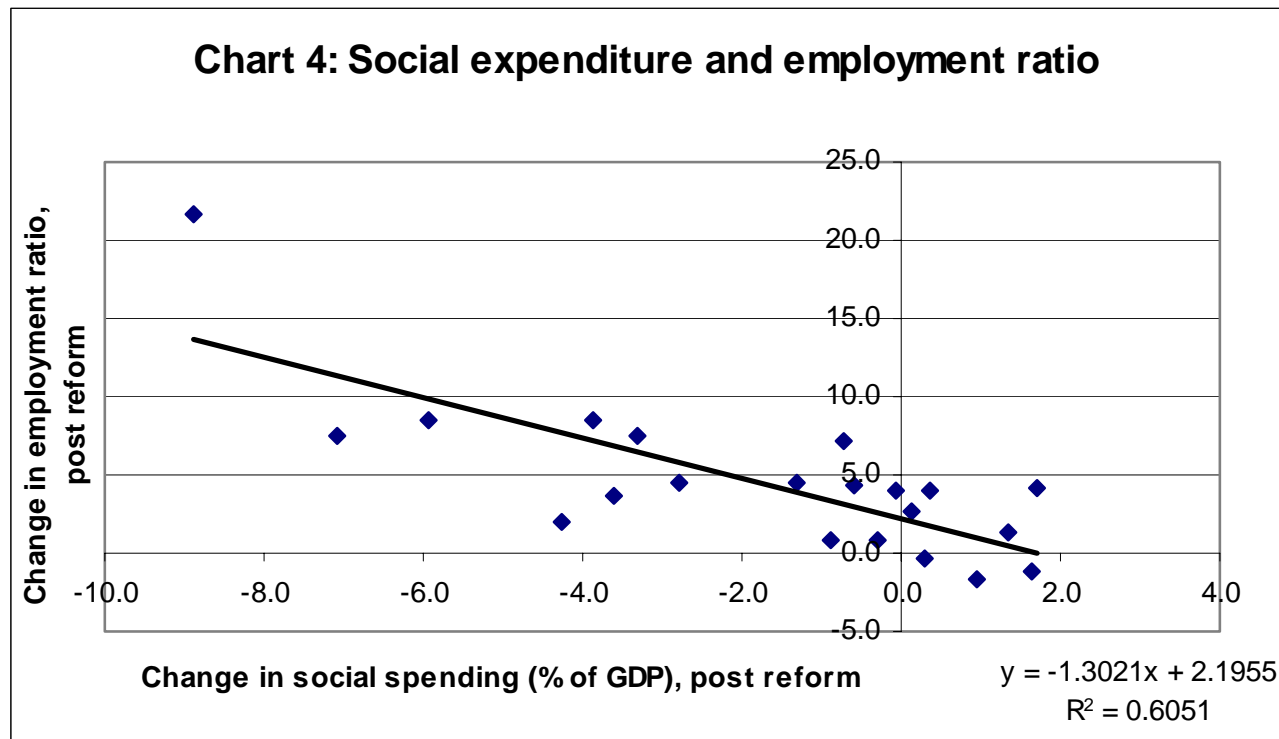
- Employment development parallel picture for trend growth: early and ambitious reformers more successful

Table 5: Employment ratio and expenditure reform

	First reform wave		Second reform wave		Change since reform
	1983-87	1988-92	1993-97	1998-2002	
Average, all countries	65.4	67.1	66.0	69.3	
Euro area	60.2	61.8	60.6	64.7	
Ambitious reformers, early	56.0	57.0	58.4	64.4	8.3
Ambitious reformers, late	69.7	70.7	66.7	70.2	3.5
Timid reformers, early	65.6	68.2	67.5	70.0	4.4
Timid reformers, late	67.7	70.4	69.8	72.2	2.4
Non reformers	64.9	65.7	65.4	67.4	

Source: EU Commission, AMECO

- Reduction of social expenditure and employment ratio more strongly correlated



Income distribution

- Complex issue:
 - Income distribution has become less equal everywhere since mid-1980s
 - Moderate correlation between spending levels and income distribution but...
 - ...much weaker correlation between changes and
 - ...higher growth compensates for lower income share

c. Income share of poorest quintile of households

	Mid-1980s	Mid-1990s	2000	mid-1980s-2000
Average, all countries	8.6%	8.4%	8.2%	-0.4%
Euro area	9.0%	8.7%	8.5%	-0.4%
Ambitious reformers, early	9.4%	8.9%	8.9%	-0.5%
Ambitious reformers, late	9.9%	10.0%	9.4%	-0.5%
Timid reformers, early	8.3%	8.0%	7.8%	-0.5%
Timid reformers, late	8.3%	8.1%	7.9%	-0.4%
Non reformers	7.9%	7.6%	7.6%	-0.3%

- Stronger growth moderates or even over-compensates for changes in income shares

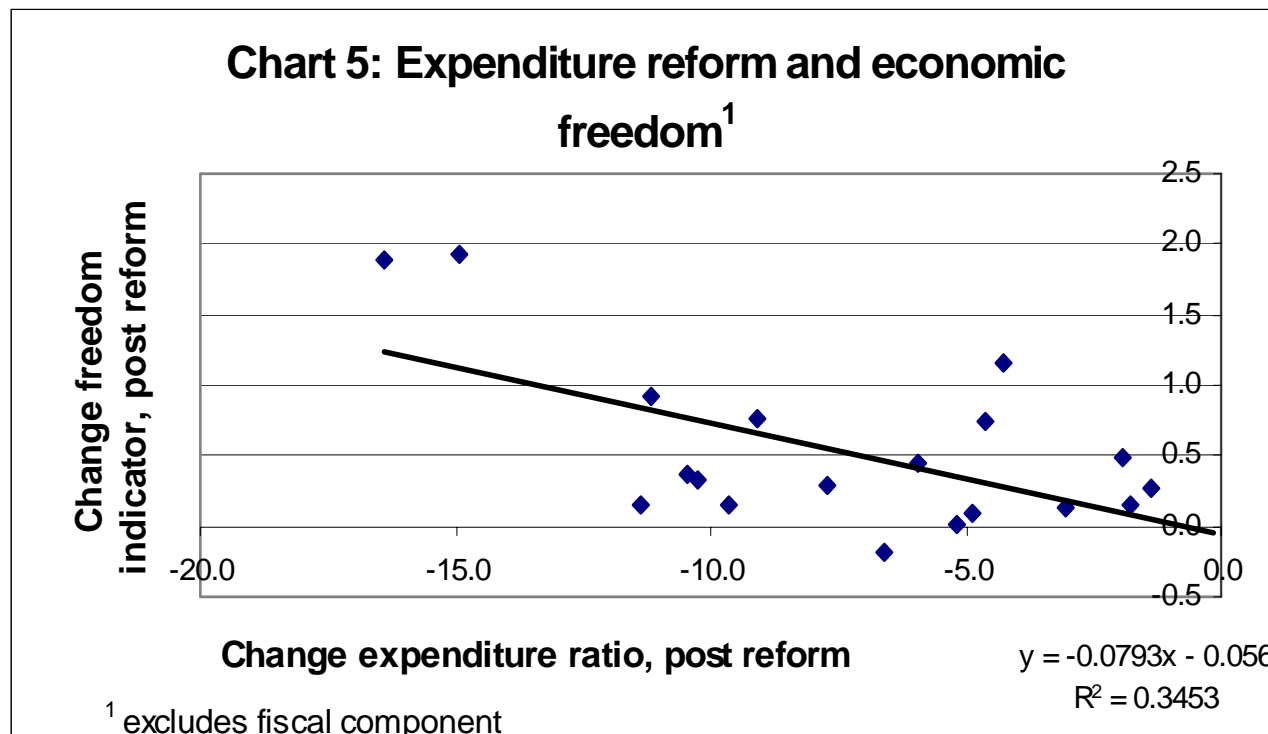
d. Per-capita GDP poorest quintile, 1995 prices, PPP US\$

	Mid-1980s	Mid-1990s	2000	mid-1980s-2000 % change
Average, all countries	7374	8677	9893	34.2
Euro area	6917	8128	9458	36.7
Ambitious reformers, early	7273	8456	10400	43.0
Ambitious reformers, late	9213	10532	11813	28.2
Timid reformers, early	6936	8141	9036	30.3
Timid reformers, late	7735	9047	9860	27.5
Non reformers	4299	4984	5819	35.4

Source: OECD

Quality of institutions

- Modest to strong correlation between expenditure reform and changes in institutional quality



IV. Conclusion

- Significant expenditure reductions in most countries with very high spending ratios, less progress by parts of continental Europe
- Expenditure reform starts in downturn
- Expenditure reform correlated with sustained improvement in fiscal and growth performance
- Small costs in terms of income distribution which are often compensated by higher growth
- Improved institutional performance
- Benefits at times take time to materialise