1. Recent Fiscal Developments and the Short-Term Outlook

In advanced economies, fiscal consolidation is proceeding, although at varying speeds

The average fiscal deficit of advanced economies is set to narrow by 1½ percent of GDP in 2013 (in both headline and cyclically adjusted terms), the fastest pace since consolidation efforts started in 2011. This average, however, reflects different trends across countries: some economies are stepping up adjustment efforts, while others are tapering them off, and still others are adopting a looser stance to support growth. Nevertheless, relative to previous projections, fiscal deficits are somewhat larger in most countries, reflecting a weaker economic environment (Figure 1, Table 1). Although 2014 budgets are in most cases still to be fleshed out, fiscal tightening is expected to moderate significantly next year as a large part of the consolidation has already taken place or is close to completion. On average, close to two-thirds of the adjustment required to reach medium-term targets has been achieved in the 10 most highly indebted countries, with the notable exception of Japan.

In many advanced economies, the pace of fiscal adjustment is expected to reach above 1 percent of GDP in 2013, but it is set to slow down significantly in 2014 in most cases.

- In the *United States,* the cyclically adjusted balance is projected to improve by 2¼ percent of potential GDP in 2013 and another ¾ percent in 2014, cumulatively some 1½ percent of GDP more than previously projected, reflecting the extension of automatic spending cuts (the sequester) into 2014, as well as unexpected revenue strength.[1] In addition to the untimely drag on short-term activity, the indiscriminate expenditure cuts could also lower medium-term growth prospects by falling too heavily on productive public outlays. Moreover, they fail to address entitlement programs, key drivers of long-term deficits. Uncertainty about the course of fiscal policy remains, as negotiations on the next fiscal year's budget continue and the debt ceiling will likely become binding in mid- to late October. The projections assume that the shutdown of the U.S. federal government is short, discretionary spending is approved and executed, and the debt ceiling is raised promptly.
- In the *United Kingdom,* the cyclically adjusted balance is projected to improve by close to 2 percent of GDP in 2013—of which 1 percent is accounted for by the transfers of profits from the Bank of England's asset purchases to the Treasury, and the rest largely by discretionary measures. Consolidation is expected to continue in 2014, with planned measures of about 1 percent of GDP.
- In *France*, fiscal withdrawal in 2013, at 1¼ percent of GDP, largely relies on revenue measures. In 2014, the pace of consolidation is set to slow to ½ percent of GDP, with the composition of consolidation expected to shift more toward expenditure.
- In *Portugal*, the cyclically adjusted balance is projected to improve by 1¼ percent of GDP given the approval of a supplementary budget in June. About one-quarter of the measures are temporary, including the reprogramming of EU structural funds and some expenditure compression. For 2014, additional consolidation of about 1 percent is projected, but meeting the deficit target will depend critically on the implementation of the recommendations of the Public Expenditure Review.
- In *Greece,* a primary balance is expected to be achieved in 2013. Further adjustment through 2016 will require additional measures, including gains in tax administration, equivalent to 3½ percent of GDP.

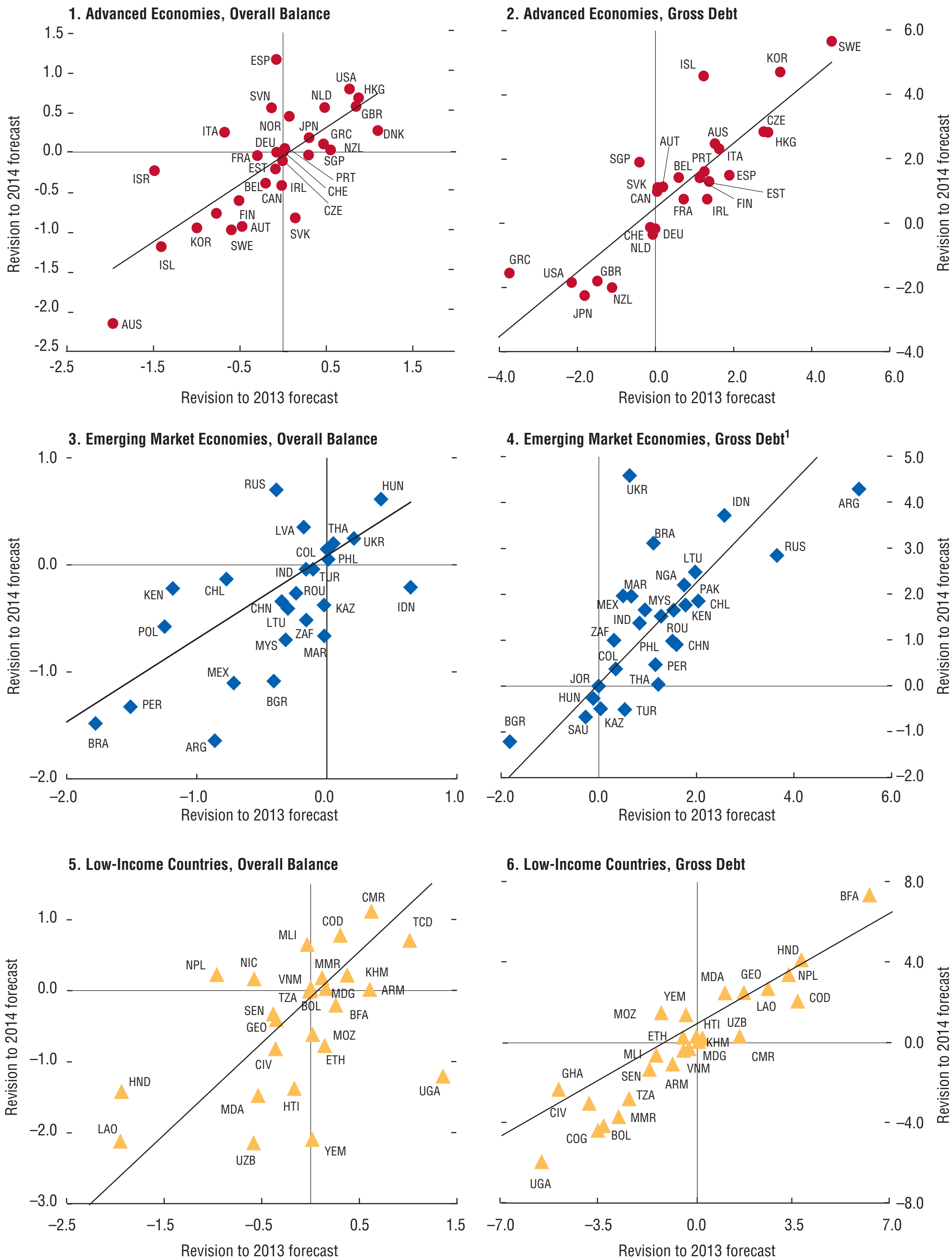
In a second group of countries, adjustment is set to proceed at a more moderate pace through 2013 and 2014.

- In *Italy*, underlying consolidation of almost 1 percent of GDP in 2013 is expected to bring the structural balance[2] close to the zero target. Nonetheless, the public debt ratio will increase as a result of

[1] Some of the revenue strength likely reflects one-off factors—such as shifting of tax payments in anticipation of higher marginal rates from January 2013—that are not captured by the cyclical-adjustment procedure. If so, the decline in the measured cyclically adjusted deficit overestimates the actual degree of tightening.

[2] The structural balance excludes the clearance of capital expenditure arrears in 2013.

Figure 1. Revisions to Overall Balance and Debt-to-GDP Forecasts since the Last *Fiscal Monitor*
(Percent of GDP)



Source: IMF staff estimates and projections.
Note: "Revision to 2014 (2013) forecast" refers to the difference between the fiscal projections for 2014 (2013) in the October 2013 *Fiscal Monitor* and those for 2014 (2013) in the April 2013 *Fiscal Monitor*.
[1]For Brazil, gross debt refers to the nonfinancial public sector, excluding Eletrobras and Petrobras, and includes sovereign debt held on the balance sheet of the central bank.

Table 1. Fiscal Balances, 2008–14

						Projections		Difference from April 2013 *Fiscal Monitor*		
	2008	2009	2010	2011	2012	2013	2014	2012	2013	2014
Overall balance *(Percent of GDP)*										
World	–2.2	–7.4	–5.9	–4.5	–4.3	–3.7	–3.0	–0.1	–0.2	–0.3
Advanced economies	–3.5	–8.9	–7.7	–6.5	–5.9	–4.5	–3.6	0.0	0.2	0.3
United States[1]	–6.5	–12.9	–10.8	–9.7	–8.3	–5.8	–4.6	0.1	0.8	0.8
Euro area	–2.1	–6.4	–6.2	–4.2	–3.7	–3.1	–2.5	–0.1	–0.2	0.1
France	–3.3	–7.6	–7.1	–5.3	–4.9	–4.0	–3.5	–0.2	–0.3	0.0
Germany	–0.1	–3.1	–4.2	–0.8	0.1	–0.4	–0.1	0.0	–0.1	0.0
Greece	–9.9	–15.6	–10.8	–9.6	–6.3	–4.1	–3.3	0.1	0.5	0.1
Ireland[2]	–7.3	–13.8	–30.5	–13.1	–7.6	–7.6	–5.0	0.1	0.0	–0.4
Italy	–2.7	–5.4	–4.3	–3.7	–2.9	–3.2	–2.1	0.1	–0.7	0.2
Portugal	–3.7	–10.2	–9.9	–4.4	–6.4	–5.5	–4.0	–1.5	0.0	0.0
Spain[2]	–4.5	–11.2	–9.7	–9.6	–10.8	–6.7	–5.8	–0.5	–0.1	1.2
Japan	–4.1	–10.4	–9.3	–9.9	–10.1	–9.5	–6.8	0.0	0.3	0.2
United Kingdom	–5.0	–11.3	–10.0	–7.8	–7.9	–6.1	–5.8	0.4	0.8	0.6
Canada	–0.3	–4.5	–4.9	–3.7	–3.4	–3.4	–2.9	–0.1	–0.5	–0.6
Others	2.5	–0.9	–0.2	0.4	0.4	0.4	0.7	0.0	–0.7	–0.7
Emerging market economies	–0.1	–4.6	–3.1	–1.7	–2.1	–2.7	–2.5	–0.1	–0.5	–0.3
Asia	–2.5	–4.3	–2.9	–2.6	–3.2	–3.4	–3.1	0.0	–0.3	–0.2
China	–0.7	–3.1	–1.5	–1.3	–2.2	–2.5	–2.1	0.0	–0.3	–0.3
India[4]	–10.0	–9.8	–8.4	–8.5	–8.0	–8.5	–8.5	0.3	–0.2	0.0
Europe	0.5	–6.1	–4.1	0.0	–0.7	–1.5	–1.2	–0.1	–0.4	0.2
Russia	4.9	–6.3	–3.4	1.5	0.4	–0.7	–0.3	0.0	–0.4	0.7
Turkey	–2.7	–6.0	–3.0	–0.7	–1.6	–2.3	–2.3	–0.2	–0.1	0.0
Latin America	–0.7	–3.6	–2.8	–2.4	–2.5	–2.8	–3.0	0.0	–1.2	–1.2
Brazil	–1.4	–3.1	–2.7	–2.5	–2.7	–3.0	–3.2	0.1	–1.8	–1.5
Mexico	–1.0	–5.1	–4.3	–3.4	–3.7	–3.8	–4.1	0.0	–0.7	–1.1
Middle East and North Africa	–5.0	–5.5	–7.0	–8.7	–9.8	–11.8	–10.5	–0.1	–2.6	–3.3
South Africa	–0.4	–5.5	–5.1	–4.0	–4.8	–4.9	–4.7	0.0	–0.2	–0.5
Low-income countries	–0.4	–4.1	–2.1	–1.7	–2.6	–3.0	–3.2	0.7	0.2	0.0
Oil producers	7.3	–2.5	–0.4	3.2	2.1	1.2	0.8	–0.2	–0.3	0.0
Cyclically adjusted balance *(Percent of potential GDP)*										
Advanced economies	–3.7	–6.2	–6.2	–5.4	–4.8	–3.4	–2.7	0.0	0.1	0.2
United States[1,3]	–5.0	–7.8	–8.0	–7.3	–6.3	–3.9	–3.2	0.1	0.7	0.7
Euro area	–3.3	–4.8	–5.0	–3.7	–2.7	–1.6	–1.2	–0.3	–0.3	0.1
France	–3.9	–5.9	–5.9	–4.8	–4.0	–2.8	–2.3	–0.9	–0.8	–0.5
Germany	–1.3	–1.1	–3.4	–1.1	0.0	–0.1	0.0	–0.1	–0.1	–0.1
Greece	–14.3	–19.1	–12.3	–8.3	–2.6	0.6	1.1	0.1	0.4	0.3
Ireland[3]	–11.9	–9.9	–8.3	–7.0	–5.9	–5.1	–3.6	0.6	0.7	0.4
Italy	–3.6	–3.5	–3.4	–2.8	–1.2	–0.7	0.1	0.0	–0.5	0.3
Portugal	–4.3	–9.4	–9.7	–3.6	–4.6	–3.3	–2.2	–1.6	–0.3	–0.2
Spain[3]	–5.6	–10.0	–8.4	–7.9	–5.4	–4.6	–4.1	–0.3	–0.4	1.0
Japan	–3.6	–7.5	–7.9	–8.5	–9.2	–9.2	–6.7	0.1	0.2	0.2
United Kingdom	–6.6	–10.3	–8.4	–6.0	–5.8	–4.0	–3.9	–0.3	0.3	–0.5
Canada	–0.6	–3.1	–4.2	–3.4	–3.0	–2.8	–2.3	–0.2	–0.6	–0.6
Others	–0.1	–2.0	–1.6	–1.4	–1.3	–1.1	–0.8	0.1	–0.6	–0.6
Emerging market economies	–1.6	–3.5	–2.8	–2.0	–2.1	–2.3	–2.1	0.0	–0.3	–0.2
Asia	–2.2	–3.8	–2.6	–1.9	–2.2	–2.4	–2.2	0.1	–0.1	–0.1
China	–0.5	–2.6	–0.9	–0.2	–0.9	–1.2	–1.0	0.0	–0.3	–0.3
India[4]	–9.5	–9.5	–9.0	–9.1	–8.1	–8.2	–8.2	0.7	0.6	0.7
Europe	–0.4	–4.0	–3.2	–0.7	–1.0	–1.4	–1.2	–0.4	–0.4	0.2
Russia	3.9	–3.2	–1.9	1.9	0.3	–0.5	–0.1	–0.2	0.0	1.1
Turkey	–3.1	–3.5	–2.4	–1.5	–1.7	–2.3	–2.1	–0.2	–0.3	–0.2
Latin America	–1.5	–2.5	–2.8	–2.8	–2.4	–2.6	–2.7	0.2	–0.9	–0.8
Brazil	–2.1	–2.3	–3.3	–3.0	–2.7	–3.0	–3.2	0.0	–1.8	–1.5
Mexico	–0.8	–3.1	–2.8	–2.3	–2.7	–2.7	–3.0	0.9	0.4	0.0
South Africa	–2.4	–3.4	–3.6	–4.1	–4.3	–4.3	–4.2	0.3	0.1	–0.2
Memorandum items:										
World growth (percent)	*2.7*	*–0.4*	*5.2*	*3.9*	*3.2*	*2.9*	*3.6*	*–0.1*	*–0.7*	*–0.6*

Source: IMF staff estimates and projections.

Note: All fiscal data country averages are weighted by nominal GDP converted to U.S. dollars at average market exchange rates in the years indicated and based on data availability. Projections are based on IMF staff assessments of current policies.

[1] U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).

[2] Including financial sector support.

[3] Excluding financial sector support.

[4] Starting in July 2013, India's data and forecasts are presented on a fiscal year basis.

the weak economy, the clearance of public arrears, and European Stability Mechanism contributions.

- In *Spain*, the IMF staff estimates that fiscal consolidation plans in train will reduce the cyclically adjusted deficit (excluding financial sector support) by ¾ percent of GDP in 2013, and by a similar magnitude in 2014. However, measures are expected to be specified in the 2014 budget to be discussed in Parliament in November.
- In *Ireland*, the implementation of the 2013 budget is on track, although buffers with respect to the 7½ percent of GDP deficit ceiling have narrowed. Consolidation efforts will continue in 2014, with projected tightening of about 1½ percent of GDP. Details are expected about the time of the 2014 budget.

Countries facing less fiscal pressures are adopting a more accommodative stance in 2013 in the face of weaker growth prospects, but they are expected to reverse gears and start tightening in 2014.

- In *Sweden*, the fiscal stance is projected to be expansionary in 2013, with the structural deficit increasing by ½ percent of GDP, on the back of the large corporate tax cut. The IMF staff projects the policy stance in 2014 to be broadly neutral, following the recently announced measures to support growth and employment, including additional income tax credits, and measures to tackle youth unemployment. A period of fiscal consolidation is now expected to begin in 2015.
- In *Germany*, a small loosening is expected in 2013 and only a modest tightening thereafter, as the deficit goals under the national debt brake rule have been achieved ahead of schedule at the federal level.
- In *Korea*, the government has launched a comprehensive housing market policy package. A supplementary budget (about 1¼ percent of GDP) aims at averting tightening—as the debt ceiling becomes binding in the face of potential revenue shortfalls—and providing modest additional stimulus.
- In *Canada*, fiscal adjustment in both 2013 and 2014 is expected to be slower than previously anticipated, reflecting a deterioration in the estimated fiscal position of provincial and local governments.

Japan continues to postpone consolidation, with the cyclically adjusted primary deficit projected to remain about 8½ percent of GDP in 2013. In 2014 and 2015, significant tightening is expected, with a two-step increase in the consumption tax rate. The recently announced decision to go forward with the first stage of the consumption tax increase to 8 percent in April 2014 is a welcome step but plans for a new stimulus in 2014 to mitigate the impact of this measure on growth put a premium on developing a concrete and credible medium-term plan as quickly as possible. Although the government has committed to halving the primary deficit by 2015 and reaching a primary surplus by 2020, a well-specified medium-term plan has not yet been outlined to achieve these targets.

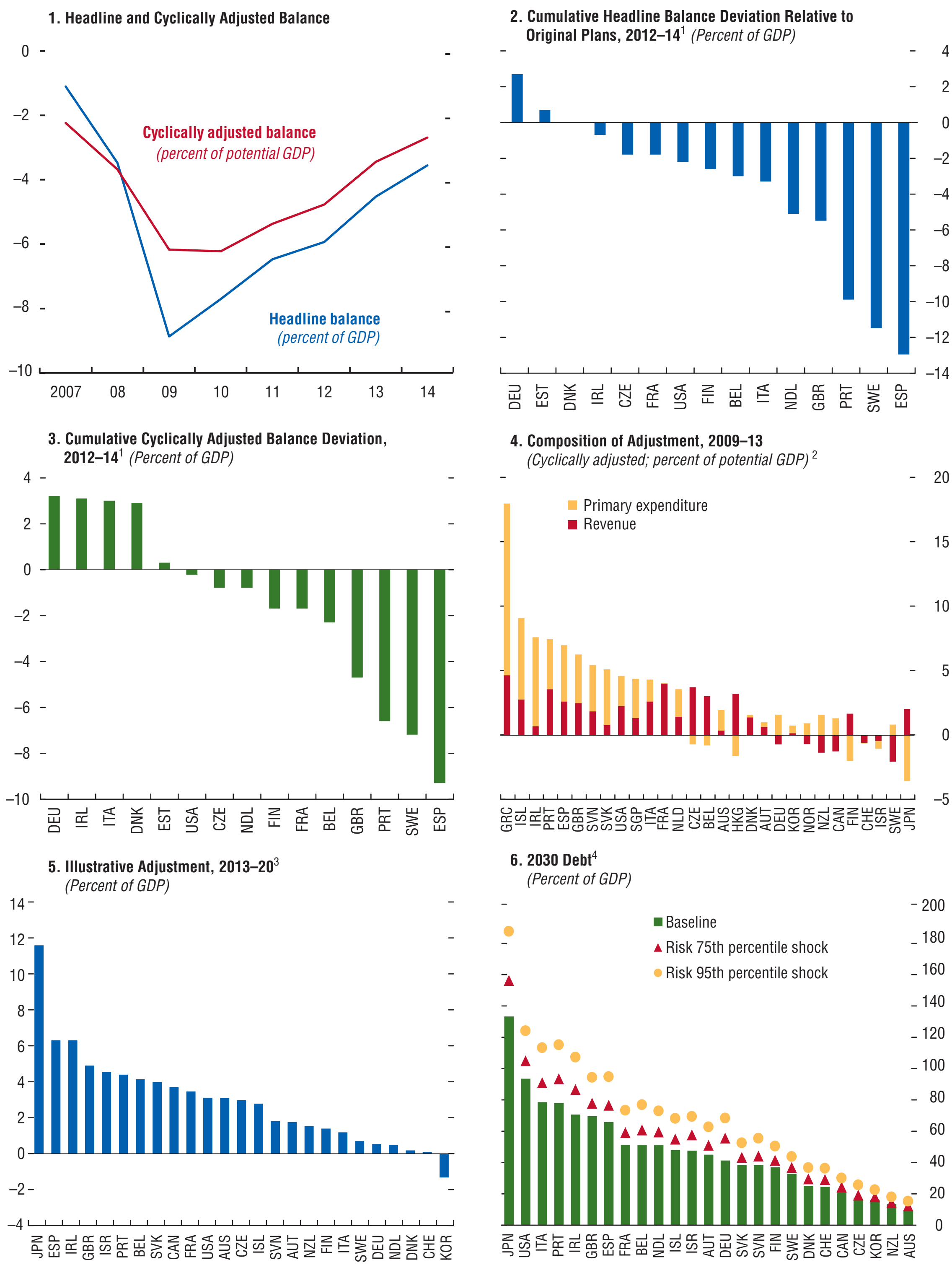
Although fiscal adjustment has picked up in 2013, headline overall balances remain in most countries weaker than projected when the fiscal correction phase started in 2011, reflecting slower-than-expected growth. In only a few countries (importantly, Germany and the United States) have fiscal developments proved generally close to plans drawn back in 2011, likely because original growth projections were close to actual outcomes (Figure 2). In most countries, however, lower growth led to a relaxation of headline deficit targets. These include euro area countries, such as those for which the European Council recently (in June 2013) sanctioned extending the deadline to attain the 3 percent deficit target. Structural balances are also lower than originally targeted in many cases, as revisions in potential output estimates and other shocks have contributed to a widening of underlying deficits. The composition of adjustment has relied on revenue more than was initially planned, with tax changes mostly guided by expediency rather than efficiency considerations (Section 2 discusses tax reform options). Meanwhile, expenditure ratios have stayed high—particularly in Europe, where they exceed 45 percent of potential GDP and remain some 1 percentage point above precrisis levels on average.[3]

In all, the average gross debt ratio in advanced economies is expected to stabilize at slightly below 110 percent of GDP—some 35 percentage points above its 2007 level (Table 2). As discussed in previous issues of the *Fiscal Monitor*, maintaining public debt at these historic peaks would leave advanced economies exposed to confidence shocks and rollover risks and hamper potential growth.[4] Thus, it remains important to lower public debt, although it will inevitably be a slow process.

[3] Future issues of the *Fiscal Monitor* will discuss spending reform options.

[4] The issue of how much high debt hampers growth—and whether there is a "threshold"—remains quite controversial. However, with few exceptions (including Panizza and Presbitero, 2012), most studies concur that the effect on potential growth is not trivial. That being said, the desirable level of debt need not be the same for all countries, as factors such as the investor base, volatility in the interest rate–growth differential, and the level of contingent liabilities also have a bearing on the appropriate debt target. See the April 2013 *Fiscal Monitor* for a review of the literature and related issues.

Figure 2. Fiscal Trends in Advanced Economies



Sources: European Commission (2013); IMF, Public Finances in Modern History database; and IMF staff estimates and projections.
Note: For country-specific details, see "Data and Conventions" in the Methodological and Statistical Appendix.
[1] For European countries, deviations refer to the differences between the 2011 and 2013 Stability and Convergence Plans. For the United States, deviations refer to differences in the 2011 and 2013 federal budgets. For Spain, the cyclically adjusted balance includes financial sector support.
[2] Cyclical adjustments to revenue and expenditure assume elasticities of 1 and 0, respectively.
[3] Required adjustment of structural primary balance to achieve structural balance targets. Structural balance targets are country specific and based on medium-term budgetary objectives.
[4] Gross general government debt, except in the cases of Australia, Canada, Japan, and New Zealand, for which net debt ratios are used. Shocks are based on the distribution of revisions to the five-year-ahead potential GDP growth between the November 2010 *World Economic Outlook* and the April 2013 *World Economic Outlook.*

Table 2. General Government Debt, 2008–14

(Percent of GDP)

						Projections		Difference from April 2013 *Fiscal Monitor*		
	2008	2009	2010	2011	2012	2013	2014	2012	2013	2014
Gross debt										
World	65.2	75.1	78.9	79.4	80.8	79.7	79.6	–0.6	–1.8	–1.0
Advanced economies	80.4	93.7	100.3	104.4	108.7	108.5	109.2	–1.4	–0.7	–0.5
United States[1]	73.3	86.3	95.2	99.4	102.7	106.0	107.3	–3.8	–2.1	–1.8
Euro area	70.3	80.1	85.7	88.2	93.0	95.7	96.1	0.1	0.7	0.8
France	68.2	79.2	82.4	85.8	90.2	93.5	94.8	–0.1	0.7	0.7
Germany	66.8	74.5	82.4	80.4	81.9	80.4	78.1	–0.1	0.0	–0.2
Greece	112.9	129.7	148.3	170.3	156.9	175.7	174.0	–1.7	–3.7	–1.6
Ireland	44.2	64.4	91.2	104.1	117.4	123.3	121.0	0.3	1.3	0.7
Italy	106.1	116.4	119.3	120.8	127.0	132.3	133.1	0.0	1.6	2.3
Portugal	71.7	83.7	94.0	108.4	123.8	123.6	125.3	0.8	1.3	1.6
Spain	40.2	54.0	61.7	70.4	85.9	93.7	99.1	1.8	1.9	1.5
Japan	191.8	210.2	216.0	230.3	238.0	243.5	242.3	0.1	–1.8	–2.3
United Kingdom	51.9	67.1	78.5	84.3	88.8	92.1	95.3	–1.5	–1.5	–1.8
Canada	71.3	81.3	83.1	83.5	85.3	87.1	85.6	–0.4	0.0	1.0
Emerging market economies	33.5	36.0	40.3	37.8	36.5	35.3	34.1	1.4	1.5	1.4
Asia	31.3	31.5	40.8	36.7	34.5	32.0	30.1	2.3	1.5	1.2
China[2]	17.0	17.7	33.5	28.7	26.1	22.9	20.9	3.3	1.6	0.9
India[3]	74.5	72.5	67.0	66.4	66.7	67.2	68.1	–0.1	0.8	1.4
Europe	23.6	29.5	29.1	27.7	26.9	28.1	27.5	0.9	2.0	0.8
Russia	7.9	11.0	11.0	11.7	12.5	14.1	14.6	1.6	3.7	2.8
Turkey	40.0	46.1	42.3	39.1	36.2	36.0	34.9	–0.2	0.5	–0.5
Latin America	50.4	53.2	51.7	51.5	52.0	51.5	51.6	0.1	1.4	2.5
Brazil[4]	63.5	66.8	65.0	64.7	68.0	68.3	69.0	–0.4	1.1	3.1
Mexico	42.9	43.9	42.4	43.6	43.5	44.0	45.8	0.0	0.5	2.0
Middle East and North Africa	62.3	64.9	66.8	70.1	75.5	81.8	83.8	0.5	3.0	6.5
South Africa	27.8	31.3	35.8	39.6	42.3	43.0	44.7	0.0	0.3	1.0
Low-income countries	39.9	42.7	41.8	40.8	41.9	41.4	42.2	–0.9	–1.0	0.3
Oil producers	22.1	24.9	24.3	22.2	22.0	23.5	24.2	–0.2	0.6	0.9
Net debt										
World	36.5	43.8	45.6	47.4	48.7	48.9	49.3	–1.0	–0.5	–0.3
Advanced economies	51.4	61.7	66.7	71.9	76.0	77.5	78.7	–1.7	–1.0	–0.9
United States[1]	52.4	64.6	72.8	79.9	84.1	87.4	88.3	–3.8	–1.7	–1.3
Euro area	54.1	62.4	65.6	68.2	72.2	74.9	75.6	0.3	1.0	1.1
France	62.3	72.0	76.1	78.6	84.0	87.2	88.5	–0.1	0.7	0.7
Germany	50.1	56.7	56.2	55.3	57.4	56.3	54.6	0.1	0.0	–0.2
Greece	112.4	129.3	147.4	168.0	154.8	172.6	172.6	–15.9	–9.3	–7.6
Ireland	21.2	38.6	70.4	85.1	92.8	105.5	107.9	–9.5	–0.6	0.3
Italy	89.3	97.9	100.0	102.6	106.1	110.5	111.2	2.9	4.7	5.2
Portugal	67.5	79.7	89.6	97.9	112.4	117.5	119.3	0.8	2.5	2.8
Spain	30.8	42.5	50.1	58.6	73.5	80.8	85.8	1.6	1.6	1.1
Japan	95.3	106.2	113.1	127.4	133.5	139.9	141.8	–0.9	–3.5	–4.9
United Kingdom	48.0	62.4	72.2	76.8	81.6	84.8	88.0	–1.2	–1.3	–1.6
Canada	22.4	27.6	29.7	32.4	34.7	36.5	38.0	0.1	0.6	1.3
Emerging market economies	23.0	27.9	28.0	26.6	24.7	24.4	23.7	0.1	0.9	1.2
Asia	…	…	…	…	…	…	…	…	…	…
Europe	21.9	27.8	28.9	27.8	25.8	26.0	23.6	0.2	1.6	–0.5
Latin America	31.1	34.7	33.8	32.3	31.0	30.6	31.2	0.1	0.6	1.9
Middle East and North Africa	52.9	55.2	57.6	61.6	67.4	74.6	77.4	0.5	2.9	6.3
Low-income countries	29.5	34.2	35.7	34.3	36.9	37.1	38.2	0.0	0.1	0.7

Source: IMF staff estimates and projections.

Note: All fiscal data country averages are weighted by nominal GDP converted to U.S. dollars at average market exchange rates in the years indicated and based on data availability. Projections are based on IMF staff assessments of current policies.

[1] U.S. data are subject to change pending completion of the release of the Bureau of Economic Analysis's Comprehensive Revision of the National Income and Product Accounts (NIPA).

[2] Up to 2009, public debt data include only central government debt as reported by the Ministry of Finance. For 2010, debt data include subnational debt identified in the 2011 *National Audit Report*. Information on new debt issuance by the local governments and some government agencies in 2011 and 2012 is not yet available, hence debt data reflect only amortization plans as specified in the 2011 *National Audit Report*. Public debt projections assume that about 60 percent of subnational debt will be amortized by 2014, 16 percent over 2015–16, and 24 percent beyond 2017, with no issuance of new debt or rollover of existing debt. For more details, see Box 4 in the April 2013 *Fiscal Monitor*.

[3] Starting in July 2013, India's data and forecasts are presented on a fiscal year basis.

[4] Gross debt refers to the nonfinancial public sector, excluding Eletrobras and Petrobras, and includes sovereign debt held on the balance sheet of the central bank.

There are two possible approaches to assessing the effort this would require. The first is to focus on the attainment of a certain debt-to-GDP ratio by a certain date, raising the primary balance to the level needed to attain the goal. Previous issues of the *Fiscal Monitor* have shown illustrative scenarios linked to specific debt targets (see Statistical Table 13a for an update of the scenarios targeting the attainment of a 60 percent debt target by 2030).[5]

Alternatively, the focus could be on attaining some given fiscal balance that would lead to a decline of the debt ratio over time. Focusing on the overall fiscal balance rather than a specific long-term debt objective has political and economic appeal. It can usefully focus the attention of policymakers. Once a certain fiscal balance has been achieved, the pace of decline in the debt ratio reflects the growth rate of nominal GDP, so this approach embodies an element of cyclicality, as the debt ratio drops faster during periods of faster growth. The stabilization dimension is enhanced if the target is defined in cyclically adjusted terms. A recent study of the relation between debt and growth concludes that once the debt ratio is on a steady downward path, the impact of high debt on growth loses statistical significance (Pescatori, Sandri, and Simon, 2013).

Simulations of advanced economies' debt paths under existing medium-term plans or, in their absence, gradual achievement of a structural budget balance consistent with the IMF staff's medium-term advice illustrate that point.[6] The average debt ratio would decline to about 70 percent of GDP by 2030 (Figure 2, Statistical Table 13b). By then, 7 countries would still have debt above 60 percent of GDP, but only in 2 would it be more than 80 percent. These results are, of course, sensitive to assumptions about nominal GDP growth. For example, if medium-term growth were lower by 1 percentage point (in line with the 75th percentile of the distribution of potential growth revisions in the aftermath of the crisis), the average debt ratio would be about 11 percentage points higher, and greater than 80 percent of GDP in 5 countries.

These simulations imply, on average, a structural primary adjustment of about 3¾ percent of GDP between 2013 and 2020, and the maintenance of a primary surplus of 2¾ percent of GDP on average over the subsequent 10-year period. Box 1 compares this effort with the historical evidence and concludes that for most countries, achieving the medium-term target would not require an adjustment effort well above the historical record. However, a few countries would have to undertake efforts close to or above the median of the top historical performers. Maintaining that target over time would be much more demanding—it would require above-median effort for 9 countries.

[5] The April 2013 *Fiscal Monitor* discusses these scenarios as well as underlying assumptions in detail.

[6] Depending on, among other factors, the starting debt level, the resulting structural balance targets vary between a 1 percent surplus and a 3 percent deficit. It is assumed that countries attain their medium-term structural targets no later than 2020 and maintain that level thereafter.

In emerging market economies and low-income countries, fiscal buffers have become thinner and vulnerabilities are on the rise

In the face of worsening cyclical conditions, many emerging market economies are postponing consolidation. The headline overall balance for this group is expected to continue deteriorating in 2013 and broadly stabilize in 2014, albeit in many cases at still relatively contained levels.

- In *Turkey*, the overall deficit is set to widen to 2¼ percent of GDP in 2013, with real expenditure growing close to 9 percent. The deficit is projected to remain unchanged in 2014, as consolidation is unlikely to take place ahead of next year's elections.
- In *Russia*, weaker oil prices are expected to push the headline balance back into deficit. Although the country's new oil-based fiscal rule is holding, spending pressures are emerging (through, for example, loan guarantees). From 2014 onward, the deficit is expected to widen further, reflecting the impact of declining oil revenues and expenditure floors.
- In *China*, the fiscal stance is expected to be mildly expansionary owing to targeted support to small and exporting companies. Headline deficits are expected to improve gradually over time. Fiscal space, however, is considerably more limited than headline data suggest once quasi-fiscal operations are taken into account (see Box 4 of the April 2013 *Fiscal Monitor*). Expanding the definition of government to include local-government financing vehicles and off-budget funds results in an estimated "augmented" fiscal deficit of 10 percent of GDP and "augmented" debt of nearly 50 percent of GDP in 2012 (IMF, 2013b). These figures remain tentative. The Chinese authorities have launched an in-depth audit of the fiscal position of local governments, a key step to better understanding fiscal conditions.
- In *Brazil*, the headline deficit would remain close to 3 percent of GDP in 2013, as the authorities have

lowered their primary surplus objective and revenue collection remains weak, reflecting a sluggish recovery and the extension of revenue measures. In 2014, the fiscal stance is expected to remain neutral. Quasi-fiscal operations in the form of policy lending are expected to moderate and remain below 1 percent of GDP through 2015.

- In *South Africa*, fiscal tightening has been postponed to buoy economic activity. The deficit will remain at 5 percent of GDP in 2013–14, with debt having increased some 15 percentage points since the crisis began.
- In *India,* consolidation has become more challenging. The deficit is expected to increase to 8½ percent of GDP in FY2013/14, largely because of the downward revision in GDP growth, the rupee depreciation, and higher global oil prices. Although greater tax compliance and ongoing fuel subsidy reforms are expected to reduce the structural primary deficit, any major reform effort will likely be postponed until after the 2014 general elections.
- Most *Arab countries in transition* (ACTs) are faced with the challenging task of consolidating their fiscal accounts in a difficult sociopolitical and external environment. Many have begun to address the problem of large untargeted energy subsidies. Nonetheless, deficits in these countries are still expected to rise or remain substantial, ranging from 5½ percent of GDP in Morocco to about 13 percent of GDP in Egypt this year. Debt is expected to increase, in some cases to more than 80 percent of GDP in 2013 (Box 2). Except in the case of Yemen, the fiscal position is expected to improve in ACTs from 2014 onward.

Altogether, the simple average of the debt ratio for emerging market economies is projected to increase in 2013–14, albeit at a moderate pace. Many countries (for example, Egypt, Morocco, Poland, and Ukraine) have seen fiscal vulnerabilities increase. This is evidenced by a shrinking or even negative fiscal space—as measured by the primary balance gap[7]—as downward revisions to potential growth and rapidly increasing primary spending have pushed structural deficits above previous estimates (Figure 3). Quasi-fiscal activities add to vulnerabilities, as much of the increase in the stock of debt since the beginning of the crisis is explained by transactions below the line.[8]

In low-income countries, fiscal deficits are also expected to continue to widen in 2013 and broadly stabilize in 2014 at more than 1½ percentage points above precrisis levels. The fiscal position is projected to improve in only a few oil importers in 2013, mostly owing to temporary factors, but to deteriorate or remain unchanged in most others, largely driven by spending pressures.

- In *Burkina Faso*, the deficit will be reduced to 2¼ percent of GDP in 2013 thanks to a rebound in agricultural production and strong gold exports. In *Uganda,* the overall balance is set to improve because of expected one-off tax revenues and delays in a large infrastructure project; excluding these one-off factors, the fiscal stance remains broadly unchanged. Other oil importers will, however, not register much of an improvement.
- Weak oil production is projected to weigh on the performance of most oil exporters (for example, *Chad* and the *Republic of Congo*), with only a few countries containing the deficits, thanks to efforts to raise non-oil revenue (*Sudan*) or control subsidies and the wage bill (*Ghana*).
- Deficits in fragile states are projected to remain large because of high infrastructure, social spending, or both (*Côte d'Ivoire*) or weak revenues (*Haiti* and *Myanmar*).

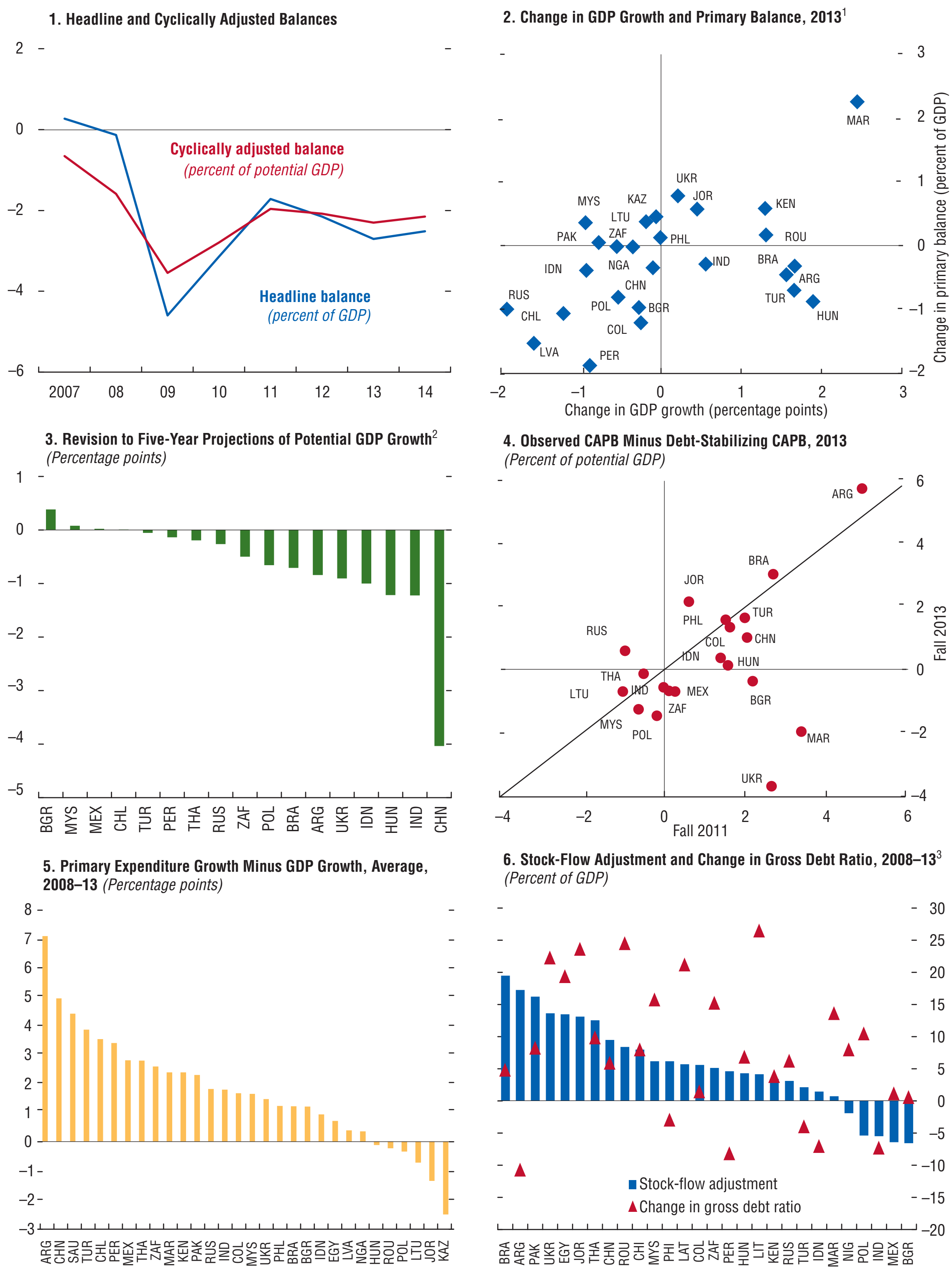
As in emerging market economies, fiscal space has declined in low-income countries. Spending has often outpaced output growth since the onset of the crisis. Even when these outlays respond to pressing developmental needs—for example, in infrastructure and health and education—there are concerns that their quality still lags behind (Figure 4).

In addition, spending growth has not always been matched by revenue mobilization efforts, an imbalance that declining commodity prices and aid shortfalls may exacerbate in coming years. With oil prices expected to decline by close to 20 percent over the next five years, oil exporters would need to adjust spending by 2 percent of GDP (assuming an elasticity of revenues to oil prices of 1), unless alternative sources of revenues are found. Also, aid data from donors indicate that disbursements may decline in many countries over 2014–15, in some cases by a large amount (Figure 5). Simple simulations suggest that a 10 percent cut in bilateral

[7] The primary balance gap is defined as the difference between the actual primary balance and the primary balance required to stabilize the debt at current levels, taking 2013 as the year of reference.

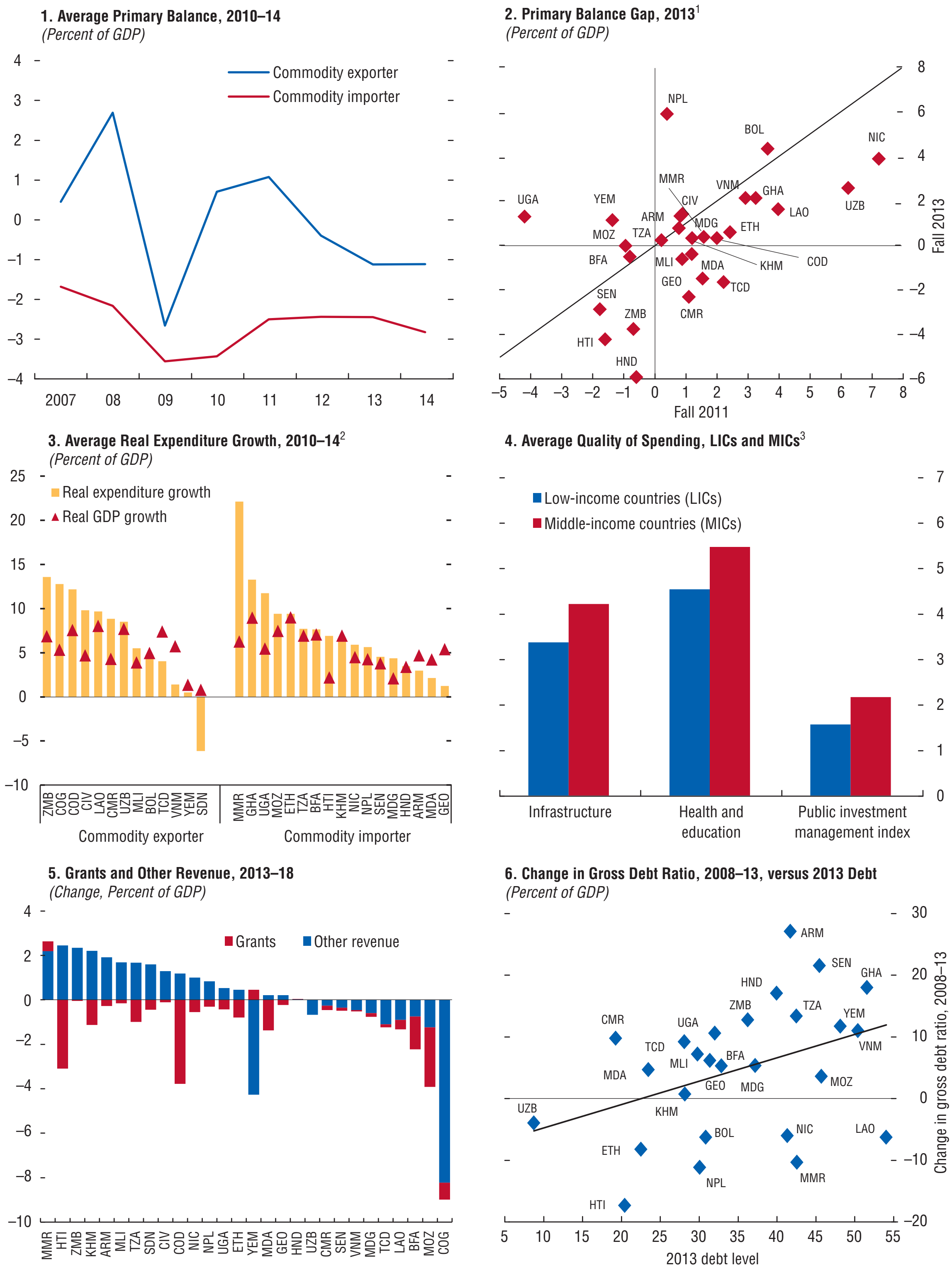
[8] For example, in Brazil policy lending to public financial institutions amounted to 8 percent of GDP from 2008 to 2012. In China, local-government financing vehicles and off-budget funds are estimated to account for about 19 percent of GDP.

Figure 3. Fiscal Trends in Emerging Market Economies



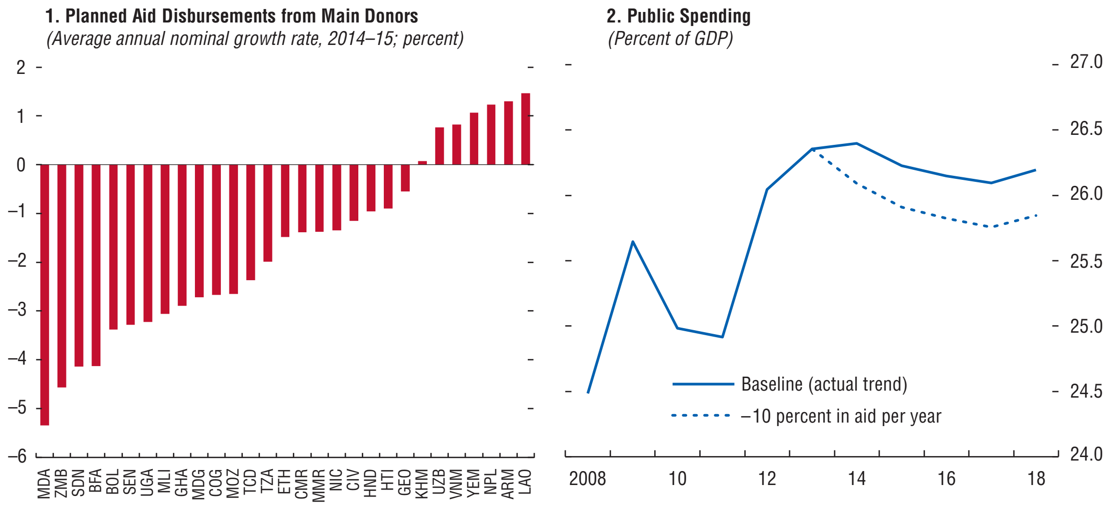
Source: IMF staff estimates and projections.
Note: CAPB = cyclically adjusted primary balance.
[1] Change relative to 2012.
[2] Differences between October 2013 and September 2011 projections.
[3] For a definition of *stock-flow adjustment*, see the Glossary. For Brazil, gross debt refers to the nonfinancial public sector, excluding Eletrobras and Petrobras, and includes sovereign debt held on the balance sheet of the central bank.

Figure 4. Fiscal Trends in Low-Income Countries



Sources: Organisation for Economic Co-operation and Development; Schwab (2012); and IMF staff estimates and projections.
[1] Primary balance gap is defined as primary balance less debt-stabilizing primary balance.
[2] Real expenditure growth is calculated using nominal expenditure deflated by the GDP deflator.
[3] Unweighted average. Higher scores indicate better quality.

Figure 5. Public Spending and Aid Contraction Scenario in Low-Income Countries, 2008–18



Sources: IMF staff calculations based on Organisation for Economic Co-operation and Development data on actual and planned country programmable aid disbursements in countries eligible for support under the Poverty Reduction and Growth Trust (2013–15).
Note: Pass-through is set to 0.8 for full contraction of spending and in line with the proportion of grants in official assistance.

aid would lead to a reduction in spending of about ½ percent of GDP on average, without a compensating increase in domestic sources of revenue.[9] Countries with high aid dependency (such as Burkina Faso, Haiti, Mali, Mozambique, and Tanzania) would have to scale down spending by more than 1 percent of GDP.

Fiscal sustainability risks remain high in advanced economies and are rising in emerging market economies

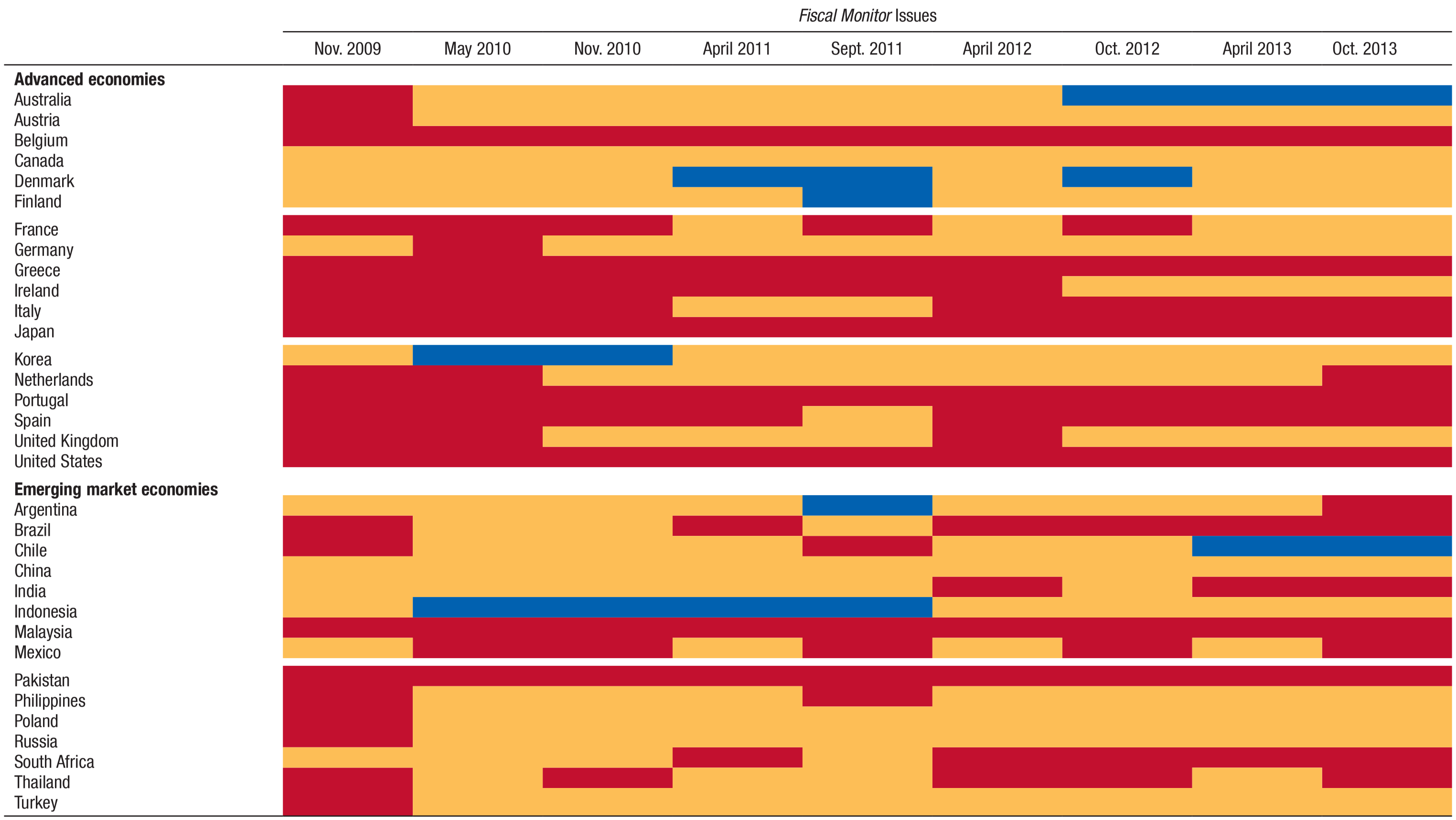
Notwithstanding progress on fiscal consolidation, underlying fiscal vulnerabilities remain elevated in many advanced economies, reflecting persistently high debt, increasing uncertainty about the growth and interest rate environment, and failure to address long-term spending pressures (Tables 3 and 4). Fiscal vulnerabilities are also increasing in emerging market economies (Figure 6)—although from a lower level—as higher spreads and weaker growth prospects push negative interest rate–growth differentials closer to zero. Resource-rich economies that used revenue windfalls to fund large spending increases in recent years face particular challenges, as commodity prices (including oil and metals) have fallen and are expected to remain depressed (see the October 2013 *World Economic Outlook*), pushing these countries closer to a deficit position.[10] Gross financing needs in advanced economies, although still large, have stabilized at about 22½ percent of GDP (Table 5). They are set to rise in emerging market economies in 2013–14 relative to previous projections, mainly driven by higher levels of maturing debt. They are particularly large (exceeding 20 percent of GDP) in Egypt, Jordan, Hungary, and Pakistan, reflecting short maturities and high deficits (Table 6).

Age-related spending remains a key source of medium-term vulnerability, with projected growth of more than 4 percent of GDP in advanced economies and 3¼ percent of GDP in emerging market economies through 2030. The growth of public health spending has slowed across the board in advanced economies over the past three years, but econometric analysis suggests this is due more to deteriorating macroeconomic and fiscal conditions than to structural improvements in the efficiency of health care systems (Appendix 1). Nonetheless, in those economies in which the economic downturn and fiscal pressures have been more pronounced, health care spending growth is likely to remain significantly below precrisis rates for some time to come.

[9] This assumes a full pass-through of the cuts for the share of aid provided as grants (about 80 percent). For a discussion of possible domestic offsets to the scaling down of aid, see Section 2.

[10] Estimates based on a sample of nine emerging market economies representing a cross-section of commodity exporters suggest that a 10 percentage point across-the-board fall in commodity prices would lead to a decline of more than 1 percent of GDP in budget revenues annually (see the April 2011 *Fiscal Monitor*).

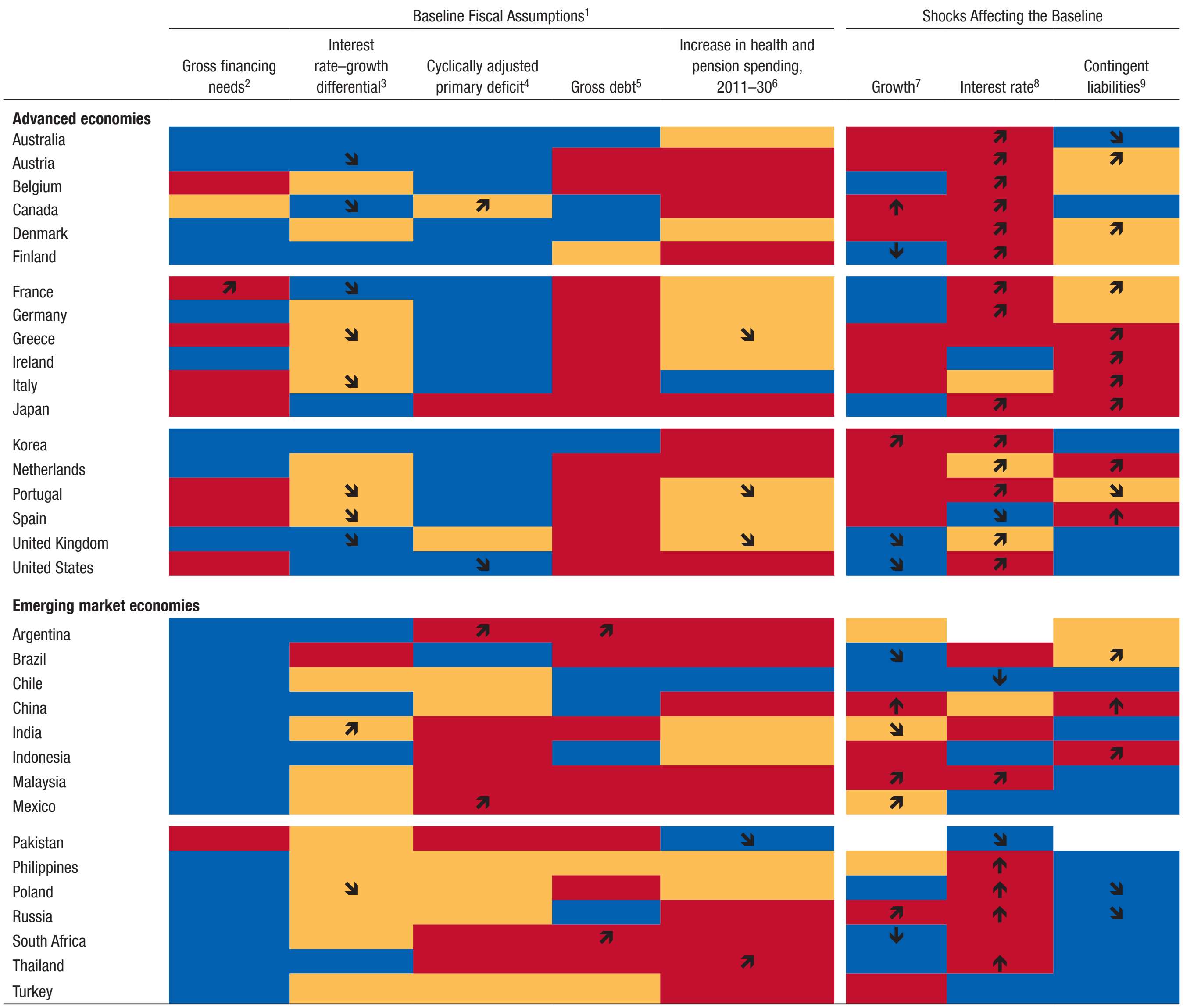
Table 3. Assessment of Underlying Fiscal Vulnerabilities over Time



Sources: Bloomberg L.P.; Consensus Economics; Thomson Reuters Datastream; Haver Analytics; and IMF staff estimates and projections.

Note: To allow for cross-country comparability, a uniform methodology is used to assess vulnerability. In-depth assessment of individual countries would require case-by-case analysis using a broader set of tools. As country-specific factors are not taken into account in the cross-country analysis, the results should be interpreted with caution. Based on fiscal vulnerability indicators presented in Table 4, red (yellow, blue) implies high (medium, moderate) levels of fiscal vulnerability. A revision of the methodology used to estimate the composite fiscal vulnerability indicator was introduced in April 2013, with a reduction in the weight assigned to shocks and a matching increase in the weight assigned to underlying fiscal vulnerabilities.

Table 4. Assessment of Underlying Fiscal Vulnerabilities, October 2013



Sources: Bloomberg L.P.; Consensus Economics; Thomson Reuters Datastream; Haver Analytics; and IMF staff estimates and projections.

Note: To allow for cross-country comparability, a uniform methodology is used for each vulnerability indicator. In-depth assessment of individual countries would require case-by-case analysis using a broader set of tools. As country-specific factors are not taken into account in the cross-country analysis, the results should be interpreted with caution. Fiscal data correspond to IMF staff forecasts for 2013 for the general government. Market data used for the *Growth, Interest rate,* and *Contingent liabilities* indicators are as of August 2013. A blank cell indicates that data are not available. Directional arrows indicate that, compared with the previous issue of the *Fiscal Monitor,* vulnerability signaled by each indicator is higher (🡅), moderately higher (🡕), moderately lower (🡖), or lower (🡇). No arrow indicates no change compared with the previous issue of the *Fiscal Monitor.*

[1] Red (yellow, blue) implies that the indicator is above (less than one standard deviation below, more than one standard deviation below) the corresponding threshold. Thresholds are from Baldacci, McHugh, and Petrova (2011) for all indicators except the increase in health and pension spending, which is benchmarked against the corresponding country group average.

[2] For advanced economies, gross financing needs above 17.3 percent of GDP are shown in red, those between 15.6 and 17.3 percent of GDP are shown in yellow, and those below 15.6 percent of GDP are shown in blue. For emerging market economies, gross financing needs above 20.6 percent of GDP are shown in red, those between 20 and 20.6 percent of GDP are shown in yellow, and those below 20 percent of GDP are shown in blue.

[3] For advanced economies, interest rate–growth differentials above 3.6 percent are shown in red, those between 0.3 and 3.6 percent are shown in yellow, and those below 0.3 percent are shown in blue. For emerging market economies, interest rate–growth differentials above 1.1 percent of GDP are shown in red, those between –4.2 and 1.1 percent of GDP are shown in yellow, and those below –4.2 percent of GDP are shown in blue.

[4] For advanced economies, cyclically adjusted deficits above 4.2 percent of GDP are shown in red, those between 1.7 and 4.2 percent of GDP are shown in yellow, and those below 1.7 percent of GDP are shown in blue. For emerging market economies, cyclically adjusted deficits above 0.5 percent of GDP are shown in red, those between –1.6 and 0.5 percent of GDP are shown in yellow, and those below –1.6 percent of GDP are shown in blue.

[5] For advanced economies, gross debt above 72.2 percent of GDP is shown in red, that between 56.1 and 72.2 percent of GDP is shown in yellow, and that below 56.1 percent of GDP is shown in blue. For emerging market economies, gross debt above 42.8 percent of GDP is shown in red, that between 29.3 and 42.8 percent of GDP is shown in yellow, and that below 29.3 percent of GDP is shown in blue.

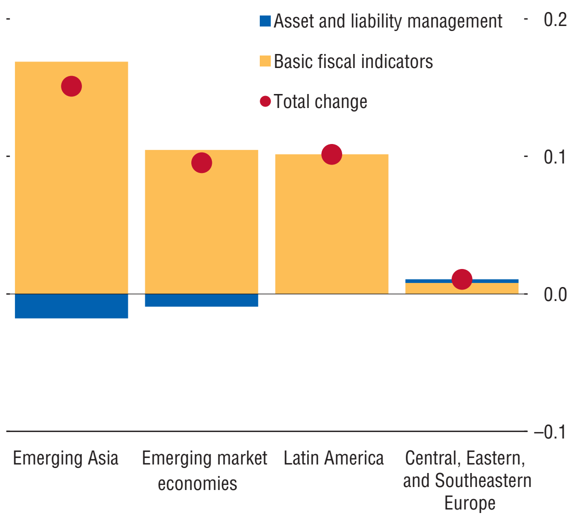
[6] For advanced economies, increases in spending above 3 percent of GDP are shown in red, those between 0.6 and 3 percent of GDP are shown in yellow, and those below 0.6 percent of GDP are shown in blue. For emerging market economies, increases in spending above 2 percent of GDP are shown in red, those between 0.3 and 2 percent of GDP are shown in yellow, and those below 0.3 percent of GDP are shown in blue.

[7] Risk to real GDP growth is measured as the ratio of the downside risk to the upside risk to growth, based on one-year-ahead real GDP growth forecasts by market analysts included in the Consensus Forecast. It is calculated as the standard deviation of market analysts' growth forecasts below the Consensus Forecast mean (downside risk, or DR), divided by the standard deviation of market analysts' growth forecasts above the Consensus Forecast mean (upside risk, or UR). This ratio is then averaged over the most recent three months. Cells are shown in red if downside risk is 25 percent or more higher than upside risk (DR/UR >= 1.25), in yellow if downside risk is less than 25 percent higher than upside risk (1 < DR/UR < 1.25), and in blue if downside risk is lower than or equal to upside risk (DR/UR <= 1).

[8] Risks to the financing cost underpinning the fiscal projection are measured as the difference between the current 10-year sovereign bond yield and the long-term bond yield (LTBY) assumption included in the *Fiscal Monitor* projections. Cells are shown in red if the current bond yield is above or equal to the LTBY, in yellow if the current bond yield is 100 basis points or less below the LTBY, and in blue if the current bond yield is more than 100 basis points below the LTBY.

[9] Fiscal contingent liabilities are proxied by banking sector uncertainty, measured as the conditional volatility of monthly bank stock returns, using an exponential generalized autoregressive conditional heteroskedastic (EGARCH) model which allows asymmetric volatility changes to positive versus negative shocks in stock returns. The rationale is as follows: bank stock returns capture market expectations of banks' future profitability and therefore—indirectly—banks' ability to maintain required capital. Higher volatility of bank returns can create uncertainty with respect to banks' ability to safeguard capital (see Sankaran, Saxena, and Erickson, 2011), increasing the probability that banks will need to be recapitalized, thereby resulting in contingent liabilities for the sovereign. Cells are shown in red if current volatility is more than two standard deviations above the historical average for January 2000–December 2007, in yellow if it is above the historical average by up to two standard deviations, and in blue if it is below or equal to the historical average.

Figure 6. Change in Fiscal Vulnerability Index, Fall 2013 Compared with Spring 2013



Sources: Baldacci, McHugh, and Petrova (2011); and IMF staff calculations.
Note: 2009 GDP weights at purchasing power parity are used to calculate weighted averages. Larger values of the index suggest higher levels of fiscal vulnerability.

Various factors contribute to increasing fiscal risks:

- *Interest rate risks* have increased, particularly in emerging market economies, in some of which uncertainty about the tapering off of U.S. monetary stimulus has contributed to higher bond fund outflows, raising the specter of sudden capital flow reversals. A simulated stress scenario suggests that 10-year bond yields could rise significantly—a jump of more than 150 basis points in countries where nonresident holdings of local-government debt are substantial, such as Indonesia, South Africa, and Turkey, if such risks were to materialize.[11] In the event, gross financing needs could increase sharply, particularly for those countries with short maturities and where the domestic investor base would be unwilling or unable to increase their holdings of government bonds to buffer against volatility (see the October 2013 *Global Financial Stability Report*). Interest rate risk has also gone up in the euro area in the face of renewed financial volatility.
- *Downside risks to growth* remain elevated in the euro area as fragmented financial markets, the need to repair private sector balance sheets, and uncertainty about policies could lead to a protracted period of stagnation. In some emerging market economies, the slow pace of structural reform is dragging down potential output growth—notably Brazil, India, and South Africa (October 2013 *World Economic Outlook*)—and weakening fiscal positions, particularly in cases in which debt levels are already high. Indeed, a 1 percentage point decline in growth in emerging market economies would result in a 0.3 percent of GDP deterioration in their fiscal balances on average.
- *Contingent liabilities* stemming from the banking sector, sometimes related to the expansion of public banks' balance sheets (e.g., in Brazil and India), are rising in several emerging market economies that experienced buoyant credit growth in recent years.[12] In some cases, nonfinancial state-owned enterprises are also a source of vulnerability (for example, in China and South Africa). In the euro area, the cleanup of banks is ongoing (Table 7) but strains are reemerging—for example, in Belgium and the Netherlands.

Strengthening fiscal balances and restoring confidence remain key policy priorities, although the degree of urgency differs across countries

In *advanced economies,* the challenge remains to advance fiscal consolidation at a pace that does not undermine the recovery and with tools that help raise potential growth.

- Consolidation should continue based on medium-term fiscal adjustment plans defined in cyclically adjusted terms, leaving room for automatic stabilizers to cushion unexpected shocks, if financing allows. The speed of adjustment should be consistent with the economic environment—so as not to unduly thwart the recovery—but also with debt levels and financing conditions. Deviations relative to these plans should be considered only if economic conditions deteriorate significantly relative to what is anticipated. Lower-than-expected growth has indeed led most countries to reset the pace of adjustment—in headline terms and often also in cyclical terms. However, the United States is adjusting too fast

[11] The scenario assumes that foreign holdings of local-currency government debt fall by 30 percent, U.S. Treasury note yield increases by 100 basis points, and the Chicago Board Options Exchange Market Volatility Index (VIX) is up by 10 percentage points. For more details, see the October 2013 *Global Financial Stability Report.*

[12] Data on guarantees and other contingent liabilities for emerging market economies are scant. For a discussion on the contingent liabilities in India and China, see the April 2013 *Fiscal Monitor.*

Table 5. Selected Advanced Economies: Gross Financing Needs, 2013–15

(Percent of GDP)

	2013			2014			2015		
	Maturing debt	Budget deficit	Total financing need	Maturing debt[1]	Budget deficit	Total financing need	Maturing debt[1]	Budget deficit	Total financing need
Japan	48.9	9.5	58.4	51.3	6.8	58.1	48.5	5.7	54.2
Italy	25.2	3.2	28.4	26.1	2.1	28.1	26.5	1.8	28.3
United States	18.1	5.8	23.9	19.6	4.6	24.3	19.1	3.9	23.0
Portugal[2]	17.8	5.5	23.3	18.1	4.0	22.1	18.0	2.5	20.5
Greece	17.0	4.1	21.1	21.8	3.3	25.1	16.5	2.1	18.6
Spain	13.5	6.7	20.2	14.8	5.8	20.6	15.7	5.0	20.7
Belgium	15.8	2.8	18.7	16.3	2.5	18.8	16.1	1.5	17.6
France	13.4	4.0	17.4	14.2	3.5	17.7	15.6	2.8	18.4
Canada	13.2	3.4	16.6	14.5	2.9	17.3	15.7	2.3	18.1
Ireland[3]	5.6	6.7	12.4	5.3	5.6	10.9	3.9	3.4	7.2
United Kingdom	5.9	6.1	12.1	6.4	5.8	12.2	8.2	4.9	13.1
Slovenia	5.0	7.0	12.0	5.7	3.8	9.5	9.3	3.9	13.2
Netherlands	8.6	3.0	11.6	9.1	3.2	12.3	12.3	4.8	17.0
Czech Republic	8.4	2.9	11.3	9.0	2.9	11.8	9.9	2.6	12.5
Slovak Republic	8.0	3.0	11.0	6.2	3.8	10.0	6.1	3.2	9.3
Iceland	6.7	2.7	9.4	7.0	1.8	8.8	1.6	1.3	2.9
Denmark	7.4	1.7	9.1	7.7	2.0	9.7	8.8	2.9	11.7
New Zealand	7.7	1.3	9.0	8.0	0.4	8.5	7.5	–0.2	7.3
Austria	6.3	2.6	9.0	6.6	2.4	9.0	6.0	1.9	7.9
Finland	6.0	2.8	8.8	6.3	2.1	8.4	6.8	1.6	8.4
Germany	7.9	0.4	8.3	7.9	0.1	8.1	5.5	0.0	5.5
Australia	3.1	3.1	6.2	3.6	2.3	5.9	4.1	0.8	4.9
Sweden	3.5	1.4	4.9	3.7	1.5	5.2	6.7	0.5	7.2
Switzerland	3.5	–0.2	3.3	3.5	–0.5	3.0	2.9	–0.7	2.3
Korea	3.1	–1.4	1.7	3.1	–1.7	1.5	3.1	–1.9	1.2
Norway	4.3	–12.4	–8.1	4.3	–11.6	–7.3	4.0	–10.2	–6.2
Average	17.6	4.6	22.3	18.8	3.7	22.5	18.4	3.0	21.4

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

Note: For most countries, data on maturing debt refer to central government securities. For some countries, general government deficits are reported on an accrual basis (see Table SA.1).

[1] Assumes that short-term debt outstanding in 2013 and 2014 will be refinanced with new short-term debt that will mature in 2014 and 2015, respectively. Countries that are projected to have budget deficits in 2013 or 2014 are assumed to issue new debt based on the maturity structure of debt outstanding at the end of 2012.

[2] Maturing debt is expressed on a nonconsolidated basis.

[3] Ireland's cash deficit includes exchequer deficit and other government cash needs and may differ from official numbers because of a different treatment of short-term debt in the forecast.

given the incipient recovery, relying on a crude tool, the sequester, with potentially undesirable effects on the composition of spending and long-term growth. A slower pace of fiscal adjustment could also be considered in some European countries, given substantial negative output gaps.

- In higher-debt countries, notably Japan and the United States, well-specified medium-term plans are urgently needed to put debt ratios firmly on a downward trajectory (and in Japan, to buttress the government's ambitious macroeconomic strategy). In the United States, in addition to entitlement reform, a fundamental tax reform aimed at simplifying the tax code and broadening the base by reducing exemptions and deductions, as well as at higher taxation of fossil fuels, could provide new revenue. In Japan, revenue efforts (notably the increase in the consumption tax to a final uniform level higher than currently envisaged) should be complemented with growth-friendly spending constraints, especially for social security. Overall, strengthening fiscal frameworks with medium-term rules to curb expenditure, tighter budget procedures, and greater independent oversight of the budget are critical to cement hard-won gains.
- In all countries, efforts should be stepped up to ensure that the composition of adjustment is more supportive of long-term growth—a critical factor for lowering debt ratios. In addition to accelerating structural reforms of labor and product markets, this would require changing the consolidation mix gradually toward tax and spending instruments that are less inimical to growth than is currently the case, while ensuring that equity goals are respected. With

Table 6. Selected Emerging Market Economies: Gross Financing Needs, 2013–14

(Percent of GDP)

	2013			2014		
	Maturing debt	Budget deficit	Total financing need	Maturing debt	Budget deficit	Total financing need
Egypt	28.1	14.7	42.8	26.7	13.2	39.9
Pakistan	25.5	8.5	34.0	29.9	5.5	35.4
Jordan	17.3	9.1	26.4	18.3	8.0	26.3
Hungary	18.1	2.7	20.8	17.3	2.8	20.1
Brazil	15.7	3.0	18.7	15.9	3.2	19.1
Morocco	9.7	5.5	15.2	9.9	4.8	14.7
South Africa	7.5	4.9	12.4	7.5	4.7	12.2
India	3.8	8.5	12.2	3.7	8.5	12.2
Mexico	7.9	3.8	11.7	7.7	4.1	11.8
Ukraine	7.4	4.3	11.7	5.2	5.1	10.3
Romania	8.6	2.3	10.9	8.4	2.0	10.4
Malaysia	6.1	4.3	10.4	5.9	4.4	10.3
Poland	5.5	4.6	10.1	5.9	3.4	9.3
Argentina[1, 2]	7.8	2.0	9.8	8.2	2.7	10.9
Turkey	7.2	2.3	9.5	8.7	2.3	11.0
Lithuania	5.5	2.9	8.4	4.0	2.7	6.7
Thailand	5.5	2.7	8.2	5.9	3.2	9.1
China[2]	5.3	2.5	7.8	4.2	2.1	6.3
Philippines	6.8	0.8	7.6	7.0	0.8	7.9
Colombia	3.9	1.0	4.9	3.2	0.7	4.0
Bulgaria	2.2	1.8	4.0	0.2	1.7	2.0
Indonesia	1.6	2.2	3.8	1.5	2.5	4.0
Latvia	1.5	1.4	2.9	6.8	0.5	7.3
Russia	1.7	0.7	2.4	2.1	0.3	2.4
Peru	2.1	–0.3	1.8	0.1	–0.3	–0.2
Chile	0.3	0.7	1.0	1.1	0.2	1.4
Kazakhstan	1.8	–4.8	–3.0	1.9	–4.1	–2.2
Average	6.5	3.1	9.6	6.1	2.8	8.9

Source: IMF staff estimates and projections.

Note: Data in table refer to general government. For some countries, general government deficits are reported on an accrual basis (see Table SA.2).

[1] Budget deficit on a cash basis, not an accrual basis as in Statistical Table 5. Total financing need takes into account only the authorities' scheduled payments.

[2] For details, see "Data and Conventions" in the Methodological and Statistical Appendix.

Table 7. Selected Advanced Economies: Financial Sector Support

(Percent of 2012 GDP, except where otherwise indicated)

	Impact on Gross Public Debt and Other Support	Recovery to Date	Impact on Gross Public Debt and Other Support after Recovery
Belgium	7.6	2.5	5.1
Cyprus	10.0	0.0	10.0
Germany[1]	12.8	1.9	10.9
Greece	21.8	6.4	15.4
Ireland[2]	40.4	5.7	34.7
Netherlands	15.6	10.7	4.9
Spain[3]	7.6	3.1	4.5
United Kingdom	6.6	2.2	4.4
United States	4.6	4.6	0.0
Average	6.9	4.1	2.9
$US billions	1,752	1,029	722

Sources: National authorities; and IMF staff estimates.

Note: Table shows fiscal outlays of the central government, except in the cases of Germany and Belgium, for which financial sector support by subnational governments is also included. Data are cumulative since the beginning of the global financial crisis—latest available data up to August 2013. Data do not include forthcoming support.

[1] Support includes here the estimated impact on public debt of liabilities transferred to newly created government sector entities (about 11 percent of GDP), taking into account operations from the central and subnational governments. As public debt is a gross concept, this neglects the simultaneous increase in government assets. With this effect taken into account, the net debt effect up to 2012 amounted to just 1.6 percent of GDP, which was recorded as deficit.

[2] The impact of the direct support measures is mainly on net debt, as significant recapitalization expenses were met from public assets. Direct support does not include asset purchases by the National Asset Management Agency (NAMA), as these are not financed directly through the general government but with government-guaranteed bonds.

[3] Direct support includes total capital injections by the Fondo de Reestructuración Ordenada Bancaria (FROB) and liquidity support.

few exceptions, the scope to increase revenues is limited and preference should be given to broadening tax bases (by eliminating undue exemptions and preferential rates) and targeting negative externalities rather than raising rates (Section 2 discusses these issues in more detail). In European economies where spending ratios are already high, the bulk of fiscal savings should arise from cutting current spending while protecting (and in some cases front-loading) public investment, to the extent possible.

There is an increasing sense that the fiscal positions of a growing number of *emerging market economies* are more vulnerable than was earlier thought, as potential output may be less than previously estimated and contingent liabilities are building up.

- Countries with high levels of deficit and debt and large gross financing needs (including Egypt, Jordan, Morocco, and Pakistan) are exposed to shocks and swings in market sentiment and thus must take early decisive steps to safeguard against adverse debt dynamics and bolster credibility. In India, gradual fiscal consolidation is needed to reduce fiscal vulnerabilities arising from high debt levels and to free fiscal space for social spending. In Brazil, the authorities should place higher priority on fiscal consolidation so as to put the gross debt–to–GDP ratio on a firm downward path. Other countries with relatively low debt ratios and deficits could wait to rebuild policy space until the global economic environment allows it but, given uncertainty about potential output and contingent liabilities, should refrain from fiscal easing—except in case of a significant slowdown and provided funding conditions permit it.
- Commodity exporters should focus on increasing their resilience to commodity price shocks by mobilizing noncommodity sources of revenue and containing hard-to-reverse current expenditures.
- A reorientation of public spending (for example, through the reduction of subsidies and containment of wage spending, complemented with targeted measures to protect the poor) could facilitate faster consolidation while supporting growth and social conditions.
- Efforts to bring all spending into public accounts (while preserving the distinction between the general government and the broader public sector) should be stepped up, as quasi-fiscal operations undermine transparency and accountability, and often result in inefficient allocation of scarce resources.

In *low-income countries,* declining concessional financing and commodity-related revenues underscore the need to mobilize domestic revenue and improve the efficiency of government expenditure, including through reforms of energy subsidies. Commodity exporters should strengthen nonresource revenue and design fiscal frameworks that ensure a strong revenue benefit while maintaining an attractive environment for investors—a central challenge in exploiting new discoveries (IMF, 2012; Daniel, Keen, and McPherson, 2010).

Box 1. Constructing an Index of the Difficulty of Fiscal Adjustment

The difficulty of implementing fiscal consolidation can be measured along (at least) two related dimensions: first, that of reaching a given primary surplus over a given period; second, that of maintaining it for some time at about that level to achieve lasting debt reduction. The *Fiscal Monitor* illustrative adjustment scenarios have usually assumed that adjustment would take place over a 10-year period and then be maintained for another 10-year period. The Public Finances in Modern History Database[1] enables a look at the historical experience along both dimensions to gauge how demanding it would be to bring debt ratios down in advanced economies.

Specifically, the distributions of the size of primary adjustments (changes in fiscal positions) and of the maximum primary surpluses (in level) have been computed for a sample of 23 advanced economies over the period 1950–2011.[2] In terms of change in the fiscal position, the maximum 10-year primary balance adjustment ranges from 3¾ to 13 percent of GDP, with the median at 8¼ percent of GDP. However, given the consolidation that has already taken place since 2011, the distribution of adjustment over the last 7 years of the 10-year period might be more relevant for assessing current consolidation plans (because it measures the difficulty of keeping "running" for 7 more years after consolidation has been "running" for 3). In that case, the distribution ranges between –1¾ and 11¼ percent of GDP, with the median at 5 percent of GDP. The maximum 10-year average level of primary surpluses ranges across countries from 1 percent to 6¾ percent of GDP, with the median at 3¼ percent of GDP.

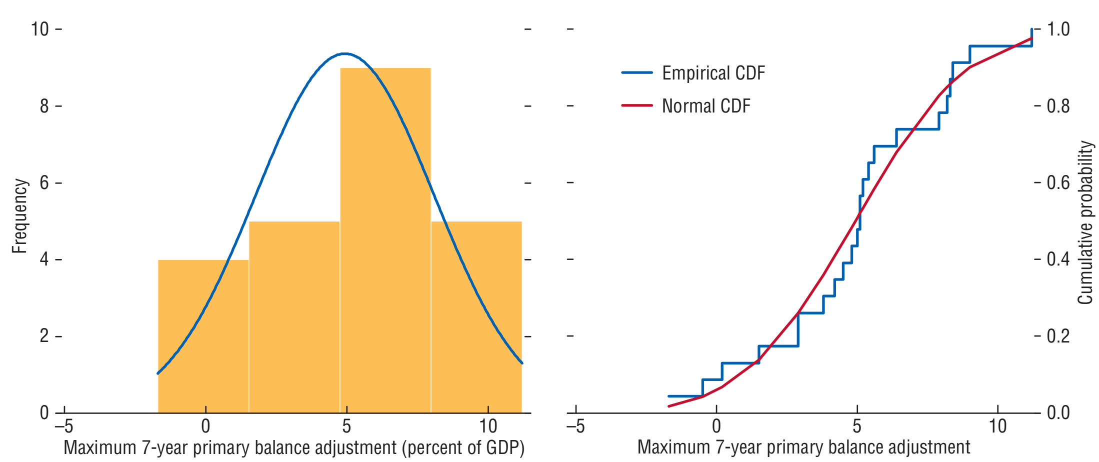
Cumulative distribution functions (CDFs) can be drawn (approximating the empirical distributions with a normal distribution)[3] for both the size of adjustment and the level of the primary surplus. These CDFs are bounded by 0 and 1 and indicate the probability that the primary surplus adjustment (or level) is at or below a given value. Indices of difficulty can then be constructed based on the CDFs (Figures 1.1 and 1.2). For instance, according to the historical evidence (depicted in Figure 1.1), achieving an adjustment of

[1] For a detailed description of the data, see Mauro and others (2013). The database is available at www.imf.org/external/np/FAD/histdb/.

[2] The historical comparison is only illustrative, as it does not take into account country-specific circumstances or the state of the global economic environment. See the April 2013 *Fiscal Monitor* for more details, including a discussion of how episodes of maximum primary balances and adjustment were identified as well as caveats in regard to using history as guide to infer the difficulty of current fiscal adjustment.

[3] Approximating the empirical distribution with a kernel density function yields a similar result.

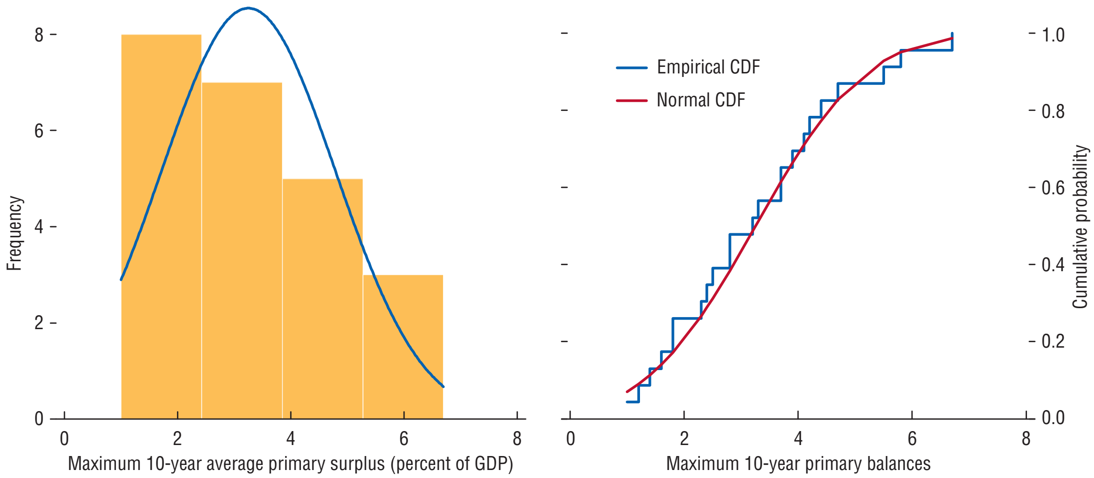
Figure 1.1. Distribution of Maximum 7-Year Improvement in Primary Balances



Sources: IMF, Public Finances in Modern History Database; and IMF staff estimates.
Note: CDF = cumulative distribution function.

Box 1 *(concluded)*

Figure 1.2. Distribution of Maximum 10-Year Primary Balances

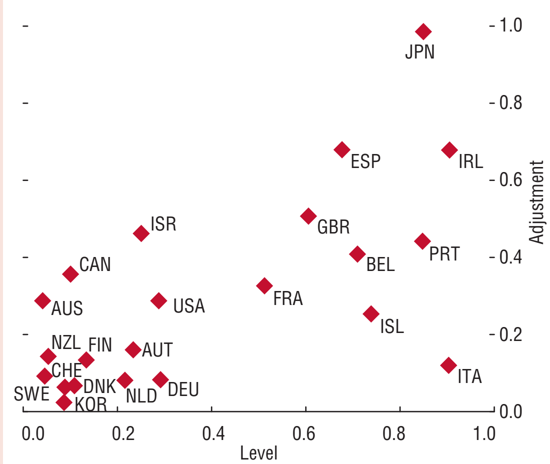


Sources: IMF, Public Finances in Modern History Database; and IMF staff estimates.
Note: CDF = cumulative distribution function.

5 percent of GDP over 7 years is associated with a cumulative probability of 0.5; the difficulty of such an adjustment can thus be considered to be median. Similarly, in Figure 1.2, maintaining a primary surplus of 6¾ percent for 10 years is associated with a cumulative probability of 1, so that any consolidation that involves maintaining the primary surplus at or above this level would be considered to be most or extremely difficult.

These indices can be used to gauge the relative difficulty entailed in the illustrative fiscal adjustment scenarios for advanced economies described in Statistical Table 13b; under these, countries consolidate gradually over a 7-year period (2014–20) to a structural budget balance consistent with the IMF staff's medium-term advice and then maintain it at this level for the next decade. Results are shown in Figure 1.3. Unsurprisingly, countries with the highest debt ratios are above the average on both dimensions of fiscal consolidation. Most points in the figure fall below a 45-degree line, suggesting that maintaining the target structural fiscal balance for an extended period of time is likely to be more challenging than adjusting to this level. Japan stands out as the country facing the most challenging consolidation, scoring a 1 on both dimensions. Ireland and Spain follow closely.

Figure 1.3. Difficulty of Long-Term Fiscal Consolidation
(Cumulative probability)



Source: IMF staff estimates and projections.
Note: Higher values indicate greater difficulty in achieving long-term fiscal consolidation.

Box 2. Fiscal Reforms to Unlock Economic Potential in the Arab Countries in Transition

Spending hikes in the aftermath of the Arab Spring raised already-high fiscal deficits and public debt (Figure 2.1). The Arab Spring caught all Arab Countries in Transition (ACTs)[1] (except Libya) with already high or rising debt levels, reflecting a combination of generalized food and fuel subsidies, high global commodities prices, low taxation, and in some cases countercyclical fiscal action.[2] During 2011–12, in response to social unrest, most ACT governments further expanded spending on subsidies and public wage bills. The increases were only partially offset by cuts in capital and other expenditures. As a result, the ACTs' public debt has grown by 12 percentage points of GDP over 2010–13.

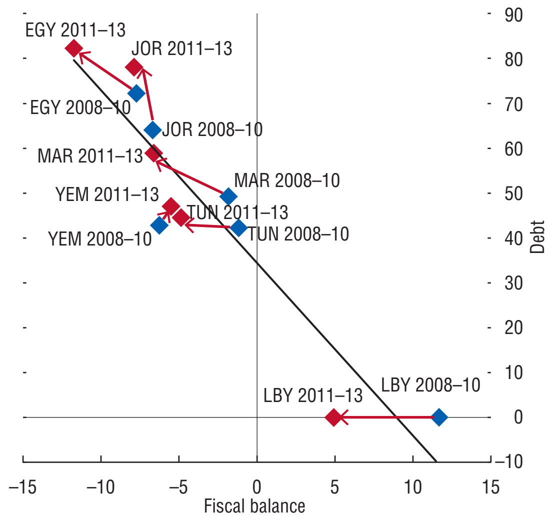
In a difficult economic and sociopolitical environment, countries need to reorient fiscal policy to foster job creation while embarking on fiscal consolidation. Under current policies, the average public debt ratio would rise by about 20 percentage points of GDP over the next five years, to close to 90 percent of GDP (Figure 2.2). Moreover, current account deficits and financing needs are substantial in many ACTs. But consolidation, however urgent, needs to take into account the ACTs' delicate sociopolitical environment and minimize adverse impacts on growth and social outcomes. This calls for a careful choice of fiscal instruments, but also for complementary measures to address poverty and unemployment. In the fiscal area, the two main goals should be improved revenue collection and a radical reprioritization of expenditures away from universal subsidies toward growth-friendly and pro-poor spending, including targeted social assistance and infrastructure (Annex III of the October 2013 *Regional Economic Outlook: Middle East and Central Asia* elaborates on specific expenditure and revenue recommendations). Given the scope of the reforms, broad political consultation will be needed to build consensus and ensure successful implementation.

A reshuffling of public expenditure can support stronger and more robust growth while enhancing social conditions. In recent years, subsidies, especially for energy, have increased faster than any other component of public outlays (Figure 2.3). Yet they are inefficient in providing social protection, as they disproportionately benefit higher-income segments of the population, which consume more than the poor. All ACT govern-

[1] The ACTs are Egypt, Jordan, Libya, Morocco, Tunisia, and Yemen. Among these, the non-oil ACTs are Egypt, Jordan, Morocco, and Tunisia. For country-specific details, see "Data and Conventions" in the text and Tables SA.2 and SA.3.

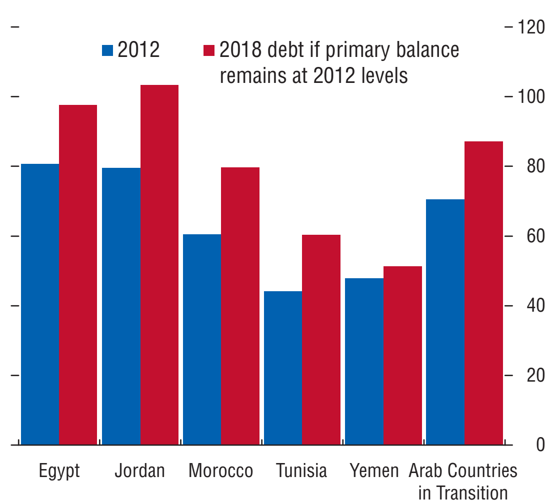
[2] In some cases, the fiscal deficit worsened because of one-off expenditures, such as bank recapitalization costs.

Figure 2.1. Arab Countries in Transition: Average Gross Debt versus Average Overall Fiscal Balance
(Percent of GDP)



Sources: National authorities; and IMF staff estimates.

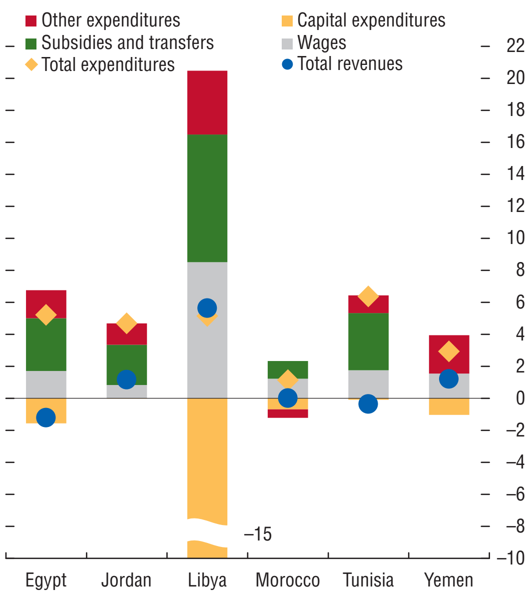
Figure 2.2. Arab Countries in Transition: Gross Debt
(Percent of GDP)



Sources: National authorities; and IMF staff estimates.

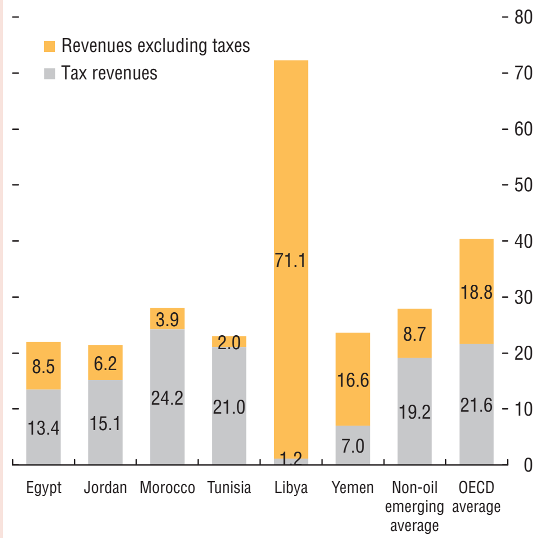
Box 2 *(continued)*

Figure 2.3. Arab Countries in Transition: Change in Revenue and Expenditure, 2010–13
(Percent of GDP)



Sources: National authorities; and IMF staff estimates.

Figure 2.4. Revenue, 2012
(Percent of GDP)



Sources: Organisation for Economic Co-operation and Development (OECD); and IMF staff estimates.

ments have embarked upon subsidy reform, although to varying degrees (October 2013 *Regional Economic Outlook: Middle East and Central Asia*).

To mitigate the social impact, part of the savings resulting from subsidy reform should be channeled toward better-targeted social safety nets or broader cash compensation schemes, and many ACTs are beginning to move in this direction. The growth of public wage bills needs to be contained, as using the public sector as employer of first and last resort is no longer an option where fiscal buffers are running low. Near-term efforts should aim at containing wage growth in real terms, complemented in the medium term by comprehensive reforms that review the size and structure of the civil service, while creating a skilled and efficient government workforce. Channeling part of the fiscal savings into growth-enhancing areas, including efficient capital spending (prioritization is important) and social outlays on education and health care, will create jobs and reduce inequities in the near term, while strengthening long-term growth prospects.

Enhancing revenue mobilization is equally important for fiscal sustainability. Tax collection is a persistent problem in non-oil ACTs, particularly in Egypt and Jordan. Tax revenue is significantly lower in oil-exporting ACTs, but nontax revenue related to oil production—which tends to be volatile—has supplemented tax receipts (Figure 2.4). Overall, the immediate challenge is to maintain macroeconomic stability, but governments should, at the same time, begin revenue reforms, seeking to strike a balance among supporting growth, enhancing equity, and strengthening revenue collection while preserving competitiveness and improving the business environment. Tax policy measures to achieve such goals may include broadening the tax base through limiting exemptions and incentives, simplifying tax systems and reducing distortions, enhancing the progressivity of personal income taxes, and raising rates where appropriate. On the tax and customs administration side, enhancing compliance and strengthening administrative capacity will be critical. Furthermore, improving taxpayers' morale through enhanced transparency, improved access to information and taxpayer services, and better communication would support revenue mobilization

Box 2 *(concluded)*

efforts. For example, publishing, as does Morocco, an annual review of tax expenditures highlighting their costs can facilitate public buy-in for reforming tax incentives. More broadly, a clear communication strategy provides assurances to taxpayers on the use of public funds, as when part of the additional revenues are used to finance well-defined growth-enhancing capital spending and well-targeted social programs.