Government Budgets in the EU Countries: Consolidation Takes Time

During the second half of the 1980s, a period characterised by a comparatively long growth phase, most countries of the European Union were able to make substantial progress towards budgetary consolidation. In the wake of the subsequent global weakening in economic activity, however, the budgetary position of almost all of these countries deteriorated rapidly. As unemployment rose, income-related transfers to private households expanded particularly sharply. Budget deficits widened significantly. Not least in an effort to meet the fiscal policy criteria for entry to the third stage of monetary union, in recent years the effects of the built-in stabilisers have been restrained in many countries, exacerbating the restrictive impact of fiscal policy. In many cases this has served to delay economic recovery, so that progress in budgetary consolidation has actually been slower than anticipated.

Public spending under the impact of consolidation efforts

The most important areas of public spending are social benefits and "government consumption", in which the remuneration of public sector employees is the dominant factor. When comparing the relative importance of the two variables across countries it is important to recognise that the proportions reflect not least institutional characteristics and different modes of financing, so that it is inadmissible to draw direct conclusions on the state's claim on macroeconomic resources on the one hand and the social security level on the other from deviations between the proportions across countries. The high figure for social benefits given for Germany, for instance, also includes the so-called "social benefits in kind" – largely hospital-related – that are provided by government, but financed by the social insurance institutions and paid for out of social insurance contributions.[1] In countries such as Great Britain in which the health service is borne not by social insurance institutions but by government, the corresponding benefits are recorded directly as government consumption. To a large extent such benefits are financed out of general taxation. Consequently social insurance contributions here – and in Denmark and Ireland – are extremely low.

Social benefits in most of the EU countries – and also in the USA and Japan – have expanded particularly dynamically: as a proportion of GDP they increased by between around 3 and 4 percentage points from the start of the 1980s to 1995 (cf. table 1). Exceptions in this regard are Belgium and the Netherlands which have stabilised their social benefits/GDP ratios in the wake of reforms of the old-age pension and the health systems. In recent years Sweden has managed to push its figure down substantially from a very high level in the early 1990s. The reasons behind the upward pressure on social security spending are primarily the indexing of transfer benefits, either to the rate of inflation or wage trends,[2] changes in age structure,[3] and also the need to finance rising unemployment. In Germany, the burden of German unification came on top of these factors. In those countries whose social security system is organised on the basis of a statutory insurance system, social insurance contributions and, to the extent that these are borne by the employer, also indirect labour costs have risen in parallel (cf. table 2).

In recent years many countries have attempted to counter the dynamic of spending growth in social services. A few examples are given below. In France, Sweden, Italy and Japan the retirement age has been increased – a measure to be introduced in Germany – and the conditions of entitlement to pension benefits tightened up. The same is true of Belgium and the Netherlands, where, in addition, the upward adjustment of pensions in line with wage growth was suspended several times. Reforms in the health service have led to cutbacks and/or increases in the share of the costs borne by patients in Germany, France, Great Britain, Belgium and Italy. In Sweden wage compensation benefits in case of sickness were reduced (no entitlement on first day and a general cut in benefit level), the sick person now bears a proportion of the costs and restrictions have been imposed on the assumption of costs for the treatment of accidents at work.

Last but not least, the benefits paid to the unemployed have also been cut back. In Germany and Swe-

[1] In the German national accounts system the social benefits in kind are recorded under government consumption. As a consequence social insurance contributions are regularly reported as being higher than social benefits, which encompass merely monetary benefits. Under the European national accounting system, based, in theory if not in practice, on uniform definitions, the corresponding figures have to be reassigned. This is the concept adhered to in this report.

[2] Cf. Willi Leibfritz, Deborah Roseveare and Paul van den Noord, Fiscal policy, Government debt and economic performance, in: *OECD Working Papers,* no. 33, Paris 1994.

[3] Cf. Willi Leibfritz, Deborah Roseveare, Douglas Fore and Eckard Wurzel, Ageing populations, pension schemes and government budgets: How do they affect saving?, in: *OECD, Economics Department Working Papers*, no. 156, Paris 1995.

Table 1

Public Spending[1)] in the EU Countries1980 to 1997

as a % of GDP

	1980	1985	1990	1991	1992	1993	1994	1995	1996[2)]	1997[2)]
					total public spending					
Belgium	57.7	61.3	54.7	55.9	56.0	56.8	56.2	54.5	54.0	53.6
Denmark	55.6	58.6	58.4	59.2	60.5	63.1	63.0	62.7	62.7	61.6
Germany	46.8	46.3	44.7	46.6	47.8	49.0	48.7	49.2	49.2	48.9
Finland	39.2	45.0	46.6	55.2	60.5	61.7	60.7	58.6	57.3	56.4
France	45.7	52.0	49.4	50.6	52.3	54.5	53.9	53.6	54.2	53.7
Greece	30.4	43.1	48.3	44.3	45.9	48.5	48.0	46.0	45.5	44.8
United Kingdom	42.5	43.7	38.8	39.9	42.4	42.6	42.4	42.6	42.2	41.4
Ireland	48.0	52.0	41.8	43.2	43.7	43.8	43.6	43.1	42.3	41.9
Italy	41.1	49.0	51.7	52.6	54.5	55.6	52.9	51.4	50.6	49.9
Netherlands	54.4	55.7	53.4	54.4	55.0	55.3	53.2	51.0	50.5	49.6
Austria	47.2	49.7	47.9	49.1	49.8	52.1	50.9	51.7	51.4	50.6
Portugal	35.6	39.5	41.4	43.8	44.0	44.6	43.4	43.9	44.1	44.2
Sweden	61.9	65.2	61.0	62.8	67.9	69.2	70.3	68.1	68.3	65.6
Spain	31.7	40.3	42.2	43.8	44.8	47.8	46.5	44.7	43.9	43.4
memo item:										
USA	33.7	35.0	34.8	35.5	36.4	36.0	35.1	35.3	35.1	35.0
Japan	32.1	32.1	32.0	31.2	32.3	34.2	34.8	36.1	37.2	37.6
					government consumption					
Belgium	17.8	17.2	14.4	14.8	14.6	15.0	15.0	14.8	14.7	14.5
Denmark	26.7	25.3	25.3	25.5	25.6	26.3	25.5	25.0	25.0	24.7
Germany	14.0	13.6	12.1	12.8	12.9	13.0	12.3	12.2	12.1	11.9
Finland	18.0	20.2	21.1	24.2	24.8	23.3	22.4	21.5	21.5	21.1
France	18.1	19.4	18.0	18.3	18.9	19.8	19.5	19.3	19.4	19.1
Greece	11.6	14.4	15.3	14.4	13.7	13.8	14.0	14.1	14.6	14.3
United Kingdom	21.6	21.1	20.5	21.6	22.1	21.9	21.6	21.3	21.0	20.5
Ireland	20.0	19.2	16.5	17.3	17.7	17.7	17.3	16.9	16.5	16.4
Italy	14.7	16.4	17.4	17.5	17.6	17.6	17.1	16.2	15.8	15.5
Netherlands	17.4	15.8	14.5	14.5	14.7	14.6	14.2	14.0	14.1	14.0
Austria	18.0	18.9	17.8	18.1	18.3	19.0	18.8	18.9	18.6	18.2
Portugal	13.5	14.4	15.6	17.1	17.5	17.7	17.6	17.7	17.9	18.2
Sweden	29.3	27.9	27.4	27.2	27.9	28.1	27.4	25.9	26.6	26.0
Spain	13.2	14.7	15.6	16.2	17.1	17.6	16.9	16.4	16.0	15.6
memo item:										
USA	17.1	17.3	17.0	17.3	16.9	16.5	15.9	15.7	15.3	15.1
Japan	9.8	9.6	9.0	9.0	9.2	9.4	9.6	9.7	9.7	9.8
					social benefits					
Belgium	21.8	23.2	21.2	21.9	22.1	22.5	22.2	21.9	22.0	21.8
Denmark	16.6	16.5	18.6	19.2	19.8	20.8	22.3	22.4	22.5	22.2
Germany	23.2	23.0	21.6	23.4	24.4	25.5	25.8	26.3	26.4	26.3
Finland	11.9	14.8	15.8	19.6	23.7	25.2	25.1	23.6	22.4	21.7
France	19.2	22.1	21.2	21.8	22.4	23.6	23.3	23.2	23.4	23.2
Greece	9.5	15.4	15.4	15.2	15.2	15.7	16.3	15.9	16.0	16.3
United Kingdom	10.6	12.7	10.7	12.0	13.4	14.0	13.9	13.9	13.7	13.5
Ireland	13.3	16.8	14.3	15.2	15.8	15.9	16.3	16.7	16.5	16.5
Italy	14.2	17.2	18.2	18.3	19.3	19.5	19.5	18.8	18.8	18.8
Netherlands	20.7	19.5	19.6	20.0	20.5	21.0	20.0	19.4	18.7	18.1
Austria	13.4	14.7	14.6	14.6	14.6	15.1	15.2	15.6	15.5	15.3
Portugal	7.3	8.1	8.8	9.5	9.9	10.9	11.3	11.5	11.6	11.6
Sweden	14.5	15.0	16.3	17.3	18.6	20.0	19.3	18.3	17.9	16.9
Spain	12.4	14.3	14.4	15.2	16.1	16.9	16.5	15.9	15.8	15.7
memo item:										
USA	11.4	11.5	11.8	12.2	13.6	13.8	13.7	14.0	14.2	14.5
Japan	10.1	10.9	11.4	10.8	11.3	11.9	12.3	13.5	14.2	14.6

Table 1 (continued)

Public Spending[1)] in the EU Countries 1980 to 1997

as a % of GDP

	1980	1985	1990	1991	1992	1993	1994	1995	1996[2)]	1997[2)]
					interest payments					
Belgium	6.1	10.7	10.7	10.3	10.7	10.5	10.2	9.2	8.6	8.6
Denmark	3.9	9.9	7.3	7.4	6.8	7.8	7.1	7.3	7.3	7.0
Germany	1.9	3.0	2.6	2.7	3.3	3.3	3.4	3.8	3.9	4.0
Finland	1.1	1.9	1.5	2.0	2.6	4.6	5.1	5.4	6.0	6.0
France	1.5	2.9	2.9	3.1	3.3	3.4	3.6	3.8	3.8	3.8
Greece	2.3	5.1	10.2	9.4	11.7	12.8	14.2	12.9	11.9	10.8
United Kingdom	4.7	4.9	3.4	3.0	2.9	2.9	3.3	3.7	4.0	4.1
Ireland	6.3	9.8	7.8	7.6	7.1	6.7	6.4	6.0	5.7	5.6
Italy	5.4	8.0	9.6	10.2	11.4	12.1	10.7	10.9	10.5	10.1
Netherlands	3.9	6.4	6.0	6.2	6.3	6.4	6.1	5.8	5.8	5.6
Austria	2.5	3.5	4.1	4.3	4.3	4.3	4.1	4.3	4.5	4.6
Portugal	2.8	8.4	8.7	8.5	7.7	6.7	5.8	5.7	5.2	4.9
Sweden	4.1	8.4	5.1	5.2	5.5	6.3	6.9	7.2	7.6	7.3
Spain	0.8	3.4	3.7	3.9	4.2	5.2	5.1	5.4	5.3	5.6
memo item: USA	1.1	2.0	2.1	2.2	2.1	2.0	2.0	2.3	2.3	2.2
Japan	3.2	4.5	3.9	3.8	3.8	3.7	3.7	3.8	3.8	3.7
					capital spending					
Belgium	4.0	2.4	1.4	1.4	1.5	1.6	1.4	1.4	1.5	1.5
Denmark	3.4	2.2	1.6	1.2	2.0	2.0	1.9	1.9	1.7	1.6
Germany	3.6	2.4	2.3	2.6	2.8	2.7	2.6	2.5	2.3	2.2
Finland	3.9	3.7	3.8	3.9	3.5	2.8	3.0	2.8	2.8	2.9
France	3.4	3.2	3.6	3.6	3.6	3.3	3.2	3.1	3.1	3.0
Greece	2.6	4.7	6.6	5.0	5.2	5.8	3.3	2.7	2.8	3.1
United Kingdom	2.5	2.0	2.3	2.1	2.1	1.8	1.8	1.7	1.4	1.2
Ireland	5.7	3.8	2.1	2.2	2.1	2.3	2.3	2.1	2.1	2.1
Italy	3.2	3.7	3.3	3.3	3.0	2.7	2.3	2.3	2.3	2.4
Netherlands	3.4	2.3	2.0	2.2	2.1	2.1	2.2	2.2	2.3	2.3
Austria	4.4	3.7	3.2	3.3	3.3	3.2	3.1	3.1	3.0	3.0
Portugal	4.0	3.0	3.4	3.5	4.1	4.2	3.8	4.2	4.4	4.6
Sweden	4.2	3.1	2.4	2.3	2.7	1.1	3.1	3.0	3.1	2.9
Spain	1.9	3.7	5.0	4.9	4.1	4.3	3.9	3.4	3.2	3.0
memo item: USA	3.5	3.6	3.5	3.4	3.3	3.2	3.1	3.1	3.1	3.0
Japan	7.1	5.6	6.1	6.2	6.9	7.8	7.7	7.7	8.1	8.0

1) Government and statutory social insurance institutions. — 2) Estimated.
Sources: OECD, Economic Outlook; DIW calculation and estimation.

den, benefit levels have been reduced, the requirements on the acceptance of job offers tightened and suspension periods imposed more rigidly. In Sweden the duration of entitlement has, in addition, been reduced and benefit-free days introduced. In Denmark, too, benefits paid by the unemployment insurance fund have been cut back, for example by reducing the duration of entitlement to unemployment benefit and tightening up the requirement to accept work. At the same time Denmark has introduced the option of paid parental and training leave and career breaks ("sabbatical years") in order to ease the pressure on the labour market.

By virtue of the cutbacks the relative importance of social benefits has been reduced slightly in recent years. In many cases a stabilisation or restriction in the extent of spending growth was achieved only.

The efforts at consolidation have achieved a more significant impact with respect to government consump-

Table 2

Fiscal Revenue[1)] in the EU Countries 1980 to 1997

as a % of GDP

	1980	1985	1990	1991	1992	1993	1994	1995	1996[2)]	1997[2)]
					total fiscal revenue					
Belgium	48.8	52.4	48.9	49.3	48.9	50.1	50.9	50.1	50.9	50.0
Denmark	52.3	56.6	56.9	57.0	57.7	59.2	59.5	60.9	61.2	60.8
Germany	43.9	45.1	42.7	43.3	44.9	45.5	46.2	45.6	45.3	45.5
Finland	42.1	48.0	52.0	53.7	54.6	53.6	54.4	53.1	54.1	55.2
France	45.6	49.1	47.8	48.4	48.3	48.7	48.1	48.6	49.9	49.9
Greece	27.8	31.5	32.1	32.8	33.6	34.3	35.8	36.8	37.6	38.0
United Kingdom	39.1	40.9	37.7	37.4	36.1	34.8	35.6	36.9	37.4	37.7
Ireland	35.8	41.3	39.5	40.9	41.2	41.4	41.3	40.7	39.6	39.3
Italy	32.5	36.4	40.8	42.4	45.0	46.1	44.0	44.3	43.9	43.6
Netherlands	50.1	52.1	48.3	51.5	51.1	52.1	50.0	47.7	47.3	46.9
Austria	45.5	47.3	45.7	46.5	47.7	47.8	46.5	45.6	47.3	47.4
Portugal	41.2	32.0	36.0	37.4	40.7	37.6	37.7	38.8	39.7	40.0
Sweden	57.9	61.4	65.2	61.7	60.1	56.9	59.4	60.0	62.8	62.4
Spain	29.5	33.4	38.1	38.9	40.7	40.4	39.6	38.6	38.6	38.7
memo item:										
USA	32.2	31.7	32.1	32.2	32.0	32.4	32.7	33.3	33.2	33.2
Japan	27.7	31.3	34.8	34.0	33.8	32.6	32.7	32.2	32.5	34.0
					taxes					
Belgium	30.9	32.0	29.4	28.9	28.7	29.1	30.8	30.6	31.3	30.9
Denmark	44.4	46.9	46.9	47.1	47.3	48.4	49.6	50.2	50.7	49.8
Germany	25.8	25.1	23.5	24.1	24.4	24.4	24.3	24.1	23.3	23.2
Finland	27.9	31.2	33.1	33.2	32.3	30.4	31.8	30.7	31.6	32.2
France	23.0	24.1	23.1	23.0	22.5	23.0	23.4	23.8	24.7	24.8
Greece	15.6	17.2	18.7	19.4	20.1	19.8	20.8	20.8	21.3	21.6
United Kingdom	29.1	30.3	28.2	27.9	27.0	26.1	26.6	27.8	28.1	28.5
Ireland	27.1	29.9	29.0	29.2	29.7	29.7	30.5	29.3	28.7	28.4
Italy	18.3	22.0	25.0	25.6	25.9	28.2	26.6	26.4	26.4	25.9
Netherlands	27.8	24.9	27.8	29.3	28.6	29.8	27.1	26.0	26.1	26.0
Austria	29.3	31.1	29.2	29.7	30.4	30.7	29.5	28.0	29.3	29.6
Portugal	17.6	20.5	22.2	22.7	24.2	22.2	23.0	23.7	24.2	24.4
Sweden	34.9	37.4	40.6	37.6	36.8	36.4	36.3	36.3	38.0	37.7
Spain	13.6	18.0	21.9	21.9	22.7	21.5	21.6	21.6	21.7	21.7
memo item:										
USA	21.9	20.7	21.0	20.9	20.8	21.3	21.6	22.2	22.1	22.0
Japan	18.1	19.8	21.8	21.2	20.5	19.3	18.4	17.7	17.8	19.0
					social insurance contributions					
Belgium	13.4	15.6	15.4	15.9	16.0	16.4	15.8	15.6	15.6	15.5
Denmark	1.9	2.9	2.6	2.6	2.7	2.8	2.9	2.9	3.1	3.7
Germany	16.8	17.5	16.8	17.9	18.2	18.8	19.2	19.3	19.9	20.0
Finland	10.2	11.6	13.0	13.9	14.9	15.4	15.6	15.1	14.9	15.3
France	19.6	21.1	21.0	21.0	21.2	21.5	21.0	21.0	21.3	21.2
Greece	9.5	12.0	11.7	11.2	11.1	12.1	12.0	12.3	12.6	12.7
United Kingdom	6.0	6.8	6.3	6.3	6.2	6.1	6.3	6.3	6.4	6.4
Ireland	4.7	5.4	5.2	5.4	5.5	5.6	5.5	5.3	5.1	5.1
Italy	12.8	13.6	14.4	14.7	15.0	15.5	15.1	14.8	14.7	14.6
Netherlands	18.1	20.5	17.0	18.0	18.5	18.6	19.6	18.9	18.7	18.4
Austria	14.9	15.1	14.8	15.0	15.4	15.8	15.6	15.8	15.9	16.0
Portugal	9.4	10.2	10.7	11.0	11.3	11.7	11.0	11.3	11.4	11.4
Sweden	15.2	14.0	15.6	15.5	14.8	14.4	14.5	14.9	16.0	16.4
Spain	13.1	13.0	13.0	13.2	14.0	14.2	14.1	13.3	13.2	13.1
memo item:										
USA	8.1	9.0	9.0	9.2	9.2	9.1	9.1	9.1	9.1	9.1
Japan	7.3	8.2	9.1	9.0	9.2	9.4	9.5	10.4	10.9	11.2
					social insurance contributions plus taxes					
Belgium	44.3	47.6	44.8	44.8	44.7	45.5	46.6	46.2	46.9	46.4
Denmark	46.3	49.8	49.5	49.7	50.0	51.2	52.5	53.1	53.8	53.5
Germany	42.6	42.6	40.3	42.0	42.6	43.2	43.5	43.4	43.2	43.2
Finland	38.1	42.8	46.1	47.1	47.2	45.8	47.4	45.8	46.5	47.5
France	42.6	45.2	44.1	44.0	43.7	44.5	44.4	44.8	46.0	46.0
Greece	25.1	29.2	30.4	30.6	31.2	31.9	32.8	33.1	33.9	34.3
United Kingdom	35.1	37.1	34.5	34.2	33.2	32.2	32.9	34.1	34.5	34.9
Ireland	31.8	35.3	34.2	34.6	35.2	35.3	36.0	34.6	33.8	33.5
Italy	31.1	35.6	39.4	40.3	40.9	43.7	41.7	41.2	41.1	40.5
Netherlands	45.9	45.4	44.8	47.3	47.1	48.4	46.7	44.9	44.8	44.4
Austria	44.2	46.2	44.0	44.7	45.8	46.5	45.1	43.8	45.2	45.6
Portugal	27.0	30.7	32.9	33.7	35.5	33.9	34.0	35.0	35.6	35.8
Sweden	50.1	51.4	56.2	53.1	51.6	50.8	50.8	51.2	54.0	54.1
Spain	26.7	31.0	34.9	35.1	36.7	35.7	35.7	34.9	34.9	34.8
memo item:										
USA	30.0	29.7	30.0	30.1	30.0	30.4	30.7	31.3	31.2	31.1
Japan	25.4	28.0	30.9	30.2	29.7	28.7	27.9	28.1	28.7	30.2

1) Government and statutory social insurance institutions. — 2) Estimated.

Sources: OECD, Economic Outlook; DIW calculation and estimation.

tion. The global easing of tensions following the opening up of eastern Europe has helped here as it has been reflected in declining defence spending. Decisive, though, was the wage and salary trend for government employees and the level of public sector employment. In most countries government consumption, as a share of GDP, was significantly lower in the mid-1990s than in the 1980s. This was achieved largely by virtue of below-average wage increases. Only in the case of Ireland – and in the USA and Japan – did this process create the scope for additional public sector employment. In most cases the impact in terms of budgetary consolidation was intensified by a decline in public sector employment, the pace of which, in some countries, exceeded that in employment as a whole.

In Denmark, France, Great Britain and Austria, government consumption remained largely constant as a share of GDP. Although in these countries, too, wage rates in the public sector were raised only moderately, it was only in Great Britain that public sector employment was cut (massively). In the other countries government helped to stabilise the labour market by expanding public sector employment.[4] In Great Britain other spending items – in particular in the national health service – expanded so strongly that government consumption could not be significantly reduced as a share of output.

The burden of interest payments has increased and accounts for a substantial proportion of public spending in many countries. At around 4% of GDP the lowest figure in Europe was in France, Germany and Great Britain; the figure is comparable to that in Japan, although substantially higher than in the USA (slightly over 2%). Interest payments tie up a substantial share of tax revenues. In Greece more than half of total tax revenues are swallowed by debt service payments; in Italy it is two-fifths, in Belgium almost one-third. At around one-sixth the interest/tax revenue quotient is markedly lower in Great Britain, France, Austria and Germany.

During the 1990s all national governments have benefited from the fall in capital market interest rates, although this has not led to a decline in the proportion of tax revenues dedicated to interest payments in all cases. Firstly, in the wake of the liberalisation of capital markets and the establishment of central bank autonomy, the governments of a number of EU Member States lost, at least in part, their privileged access to the financial institutions. Governments must now resort to the money and capital markets in order to finance their budget deficits; they can no longer fall back on low-interest loans from the central bank. Secondly, government debt increased, in some cases sharply, in 1992 and 1993 due to the recession. In Germany the fiscal burdens associated with unification, the prime cause of Germany's budget deficits in the 1990s – which widened further in 1995 when central government assumed the debts brought together in the *Erblastentilgungsfond* (fund for the servicing of outstanding debts from the former GDR) – pushed up the interest-tax revenue quotient. In Finland, France, Austria, Great Britain and Spain the quotient also increased in the wake of recession. The quotient sank, on the other hand, in Ireland, Denmark and Belgium, which made faster progress with fiscal consolidation, and in countries such as Greece and Portugal, where the interest rate cuts and thus the beneficial effect on government debt servicing payments were of a greater order of magnitude.

One method that can be interpreted as a way of reducing the interest burden quickly, effectively and significantly is the sale of public assets, with the receipts used to pay off public debt. Several countries started down this road many years ago. Yet the actual process of privatisation takes time and a glance at the net outstanding debts figures – i.e. total government debt minus accounts receivable and assets[5] – shows that in many countries there is little scope for reducing the debt burden in this way (cf. table 3).

Public capital spending has fallen victim to the pressure for spending cuts in virtually all the countries. With the exception of Portugal, where the expansion of the public infrastructure made strong progress even in the 1990s, and Japan, which consciously raised government investment in order to stimulate the sluggish domestic economy, public capital spending as a share of GDP is now lower in all the countries examined here than in the 1980s or at the start of this decade. Clearly it is here that cuts can be made most easily as, in contrast to public sector employment and statutory public transfers, the incidence of contractual obligations is less serious, allowing far greater scope to postpone or cancel projects. Yet such a trend must give cause for concern, all the more so as it has continued for some time, because public investment in infrastructure is an important complement to private sector investment. If it is neglected in the longer term, growth potential will be put at risk, the exploitation of which is urgently required if the phase of economic weakness is to be overcome.

[4] In some cases this was due to the fact that the consolidation programmes announced were in fact not, or were only partially, implemented; this is true of Austria, for example.

[5] These assets include bank deposits and accounts receivable resulting from loans to the private sector, equity holdings in private firms, the value of capital stock of publicly owned companies and – depending on the institutional setting in each country – gold and foreign currency reserves. Cf. *OECD Economic Outlook 58,* 1996, p. A76.

Table 3

Government Debt in the EU Countries 1980 to 1997

as a % of GDP

	1980	1985	1990	1991	1992	1993	1994	1995	1996[2)]	1997[2)]
					budget deficit					
Belgium	–8.9	–9.0	–5.8	–6.7	–7.1	–6.7	–5.3	–4.4	–3.2	–3.7
Denmark	–3.3	–2.0	–1.5	–2.1	–2.9	–3.9	–3.5	–1.8	–1.5	–0.8
Germany	–2.9	–1.2	–2.1	–3.3	–2.8	–3.5	–2.5	–3.5	–3.8	–3.4
Finland	2.9	3.0	5.4	–1.5	–5.8	–8.0	–6.3	–5.6	–3.2	–1.2
France	0.0	–2.9	–1.6	–2.2	–4.0	–5.8	–5.8	–5.0	–4.3	–3.7
Greece	–2.6	–11.5	–16.1	–11.5	–12.3	–14.2	–12.1	–9.2	–8.0	–6.8
United Kingdom	–3.4	–2.8	–1.2	–2.5	–6.3	–7.8	–6.8	–5.7	–4.8	–3.7
Ireland	–12.2	–10.7	–2.3	–2.3	–2.4	–2.4	–2.3	–2.4	–2.7	–2.6
Italy	–8.6	–12.6	–10.9	–10.2	–9.5	–9.6	–9.0	–7.2	–6.7	–6.4
Netherlands	–4.3	–3.6	–5.1	–2.9	–3.9	–3.2	–3.2	–3.3	–3.2	–2.7
Austria	–1.7	–2.5	–2.2	–2.6	–2.1	–4.3	–4.4	–6.2	–4.0	–3.2
Portugal	5.6	–7.5	–5.5	–6.4	–3.3	–7.1	–5.6	–5.1	–4.4	–4.2
Sweden	–4.0	–3.8	4.2	–1.1	–7.8	–12.3	–10.8	–8.1	–5.5	–3.1
Spain	–2.2	–6.9	–4.1	–4.9	–4.1	–7.5	–6.9	–6.2	–5.2	–4.7
memo item:										
USA	–1.4	–3.2	–2.7	–3.3	–4.4	–3.6	–2.3	–2.0	–1.9	–1.8
Japan	–4.4	–0.8	2.9	2.9	1.4	–1.6	–2.1	–3.9	–4.8	–3.7
					gross government debt					
Belgium	78.7	122.6	130.9	130.3	131.5	137.9	136.0	133.5	132.4	131.1
Denmark	44.7	76.6	68.0	69.1	73.2	86.0	80.2	80.1	80.0	78.3
Germany	32.8	42.5	45.5	44.4	45.8	52.0	51.6	61.6	64.2	66.0
Finland	14.1	18.9	16.9	25.6	46.2	59.5	61.7	63.0	64.1	64.2
France	30.9	38.6	40.2	41.0	45.6	52.5	54.7	57.9	60.3	62.1
Greece	22.9	47.8	81.6	83.1	99.1	111.7	110.4	111.5	109.4	107.3
United Kingdom	54.0	58.9	39.3	40.6	47.7	56.9	54.6	57.6	60.7	62.0
Ireland	71.8	102.6	97.1	96.7	94.2	97.3	91.5	85.8	82.2	79.9
Italy	57.7	82.3	106.4	110.3	116.7	118.4	123.9	123.0	123.1	123.3
Netherlands	46.9	71.5	78.8	78.8	79.4	81.1	77.6	79.1	78.6	78.2
Austria	37.3	50.5	58.3	58.7	58.3	62.8	65.0	69.4	72.3	73.9
Portugal	33.0	58.5	68.6	70.2	62.4	67.2	69.5	70.7	71.7	72.5
Sweden	44.3	66.7	44.3	53.2	71.1	76.3	81.5	81.8	83.2	81.5
Spain	18.3	50.8	50.3	51.5	54.3	65.8	68.4	71.1	73.6	75.5
memo item:										
USA	37.0	49.1	55.6	59.6	62.0	63.5	63.7	64.3	64.1	63.8
Japan	51.2	67.0	65.1	62.3	63.5	67.9	73.2	81.3	88.8	95.4
					net government debt					
Belgium	69.6	112.6	119.3	120.3	122.0	128.2	126.7	127.6	127.6	126.3
Denmark	14.2	46.3	34.0	38.9	40.8	45.6	46.0	45.8	45.7	44.1
Germany	11.8	20.8	20.6	22.2	26.7	35.1	39.6	44.1	47.0	49.3
Finland	–30.7	–27.6	–36.1	–34.8	–26.3	–18.2	–13.7	–7.1	–3.6	–2.2
France	–3.3	10.8	16.3	16.5	20.4	28.1	31.0	34.8	38.2	40.6
Greece	.	.	.	.	.	.	.	.	.	.
United Kingdom	36.2	30.6	18.8	19.2	26.1	35.5	39.6	39.6	42.7	44.0
Ireland	.	.	.	.	.	.	.	.	.	.
Italy	52.7	80.0	84.3	89.3	95.6	103.7	108.6	109.0	110.1	111.3
Netherlands	24.6	42.3	36.9	37.7	41.3	42.5	42.7	43.3	44.3	44.1
Austria	20.0	31.0	38.6	38.5	39.6	44.4	45.3	49.7	52.5	54.1
Portugal	.	.	.	.	.	.	.	.	.	.
Sweden	–13.9	14.3	–8.1	–5.2	4.7	11.0	21.9	27.8	32.3	34.0
Spain	6.1	27.5	31.7	33.4	35.7	43.1	47.6	50.3	52.8	54.7
memo item:										
USA	21.8	32.2	39.7	43.1	46.7	48.8	49.6	50.7	50.4	50.2
Japan	16.4	25.9	10.6	5.4	3.7	4.6	6.8	10.7	15.3	18.0

1) Government and statutory social insurance institutions. — 2) Estimated.
Sources: OECD, Economic Outlook; DIW calculation and estimation.

No uniform pattern on the income side

In many countries the need to impose spending discipline was intensified by the fact that governments thought it necessary to avoid any further rise in the overall burden of taxes and social insurance contributions, or even to reduce it. In many countries the main aim has been to reduce the burden of corporate taxation and of social insurance contributions, the importance of which for overall labour costs varies from country to country. In Great Britain, France, Sweden, Ireland, the Netherlands and Germany – in the latter case only for business income – the rates of income and corporation tax have been cut in recent years; the reduction has mostly applied to the top rate of tax, but in some cases has been on a broader front. In some countries – examples are Ireland, Germany and Denmark – the reduced tax incidence due to the cut in rates was partly neutralised by a broadening of the tax base.

In addition to easing the corporate tax burden, France, Great Britain, Belgium, the Netherlands and Sweden have also cut employers' contributions to the statutory social insurance schemes. This posed few problems as in most EU countries contributions are not split equally between employers and employees as in Germany; frequently the contribution paid by employers is significantly higher.[6] The contribution cuts in Great Britain and Belgium aim primarily to promote the recruitment of low-wage labour; in Belgium the cut has also been targeted at sectors in crisis. In Ireland the new reductions only apply to additional jobs created.

Despite the declarations of intent regarding tax cuts on a broad front and the steps taken in this direction, no country has achieved a lasting reduction in taxes and social insurance contributions as a share of GDP. In 1995 the tax burden was just as high in most countries as at the start of the decade, and in some countries even higher. Not least with a view to the precarious budgetary situation, tax reductions granted in one area tended to be offset by increases in other areas. In a few cases – such as Denmark – income tax was raised again, but more frequently the overall tax burden was restructured in favour of indirect taxes. Many countries increased the rate of VAT (Germany, France, Great Britain, Belgium, Ireland and Sweden) and petroleum tax (Germany, France, Italy, Belgium, Denmark, Netherlands, and Sweden), and taxes on alcohol (France, Sweden) and tobacco (France, Sweden). In a few countries steps were taken towards an ecological tax reform: cuts in direct taxes were coupled with the introduction or increases in the rate of tax on energy consumption. This occurred in Sweden, the Netherlands and Denmark.

Given that the burden of social insurance contributions increased further during the first half of the 1990s in many EU countries, the overall burden of taxation and contributions has now reached a high level. Denmark and Sweden lead the field, with taxes and contributions accounting for more than 50% of GDP. At around 35%, the burden in Great Britain and Ireland, and Greece, Spain and Portugal is still markedly lower. In the three southern European countries, the potential tax take is almost certainly far from fully realised; this is evident from the fact that the tax rates for the leading, most productive taxes are not lower than in other EU countries. An increase in the efficiency of the tax administration and greater efforts to counter tax avoidance and evasion would make an important contribution to improving the fiscal position of these countries.[7]

Many countries have little scope for a consolidation strategy based on expanding fiscal revenues by increasing taxes and social insurance contributions. The burden of direct taxes – at least those on profits – is seen as a sensitive issue in the public discussion in the light of considerations of national competitiveness; such taxes have been reduced in recent years in many countries, not least in view of the lower rates in competitor countries such as the USA and Japan. The imposition of an even heavier burden on private consumption, for instance in the form of a rise in the rate of VAT, would be less problematic in terms of competitiveness. Yet the impact this would have on inflation suggests that caution must be exercised if wage conflict and monetary restriction are to be avoided.

Any increase in social insurance contributions raises the danger of a rise in overall labour costs. It is true that many countries have the option of setting contribution rates separately for employees and employers, so that in principle the burden on wage income could be increased while the employer contribution rate remains constant. Moreover, given that government also makes a contribution to financing the social insurance system in most countries – not only in the form of the contributions it pays for public sector employees, but also in many cases in the form of grants to cover financial deficits in the insurance funds – such an increase could serve to ease the burden on government budgets. Such a step would almost certainly lead to wage conflict, however, as the trade unions would attempt to pass on, at least in part, the increased contributions to the employers in pay bargaining.

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[6] Cf. *OECD Economic Surveys,* Italy 1994, p. 110.

[7] Cf. European Commission (ed.), Towards greater fiscal discipline, in: *European Economy 3/1994,* Luxembourg 1995, p. 11 ff.

Conclusion

On a medium-term view strict spending discipline is an important precondition for the success of fiscal consolidation in the EU countries. This applies in particular to the reduction in the structural, i.e. cyclically adjusted, deficits that exist to a greater or lesser extent in most countries.[8]

Experience in the EU countries also shows, however, that a successful consolidation strategy depends not only on finding the most suitable dose of fiscal policy measures, but also on implementing them at the right time. A strategy of raising revenue and limiting spending growth should be medium-term in nature; the importance of cyclically induced deficits should not be overstated. A successful policy takes time. The efforts undertaken by most EU countries to reduce fiscal deficits and so meet the fiscal criteria for the entry into the third stage of economic and monetary union, irrespective of their economic situation and within just a few years, by cutting spending and raising revenue have had only limited success in recent years.[9] When, in the wake of the cyclical downturn, the revenue from taxes and social insurance contributions lagged behind targets and transfer payments rose rapidly, many national governments tightened their already restrictive fiscal policy stance further by limiting the impact of the built-in stabilisers of the taxation-transfer system. This strategy exacted a heavy price, because lasting economic recovery took even longer to materialise and unemployment rose. Expressed as a percentage of GDP, the budget deficits – in some cases from a high initial level – were not reduced to a sufficient extent; in a number of countries the deficit actually widened following a brief improvement in 1994. This constellation is unlikely to change fundamentally in the current and even in the coming year, despite the expected economic recovery. Gross government debt has been increasing as a proportion of GDP in virtually all countries.

Only a few countries sought consciously to counter the 1993 recession with expansionary fiscal policy measures. In Denmark, for instance, public spending on labour market initiatives and in the fields of education, health and culture was increased, while at the same time the overall tax and contribution burden was eased in the course of a tax reform. In Ireland the government responded with tax concessions and a cut in tax rates and an improvement in social benefits. In the Netherlands spending on government consumption was increased and, at the same time, tax and contribution cuts announced. In the final analysis these countries have fared better than many other EU countries that orient fiscal policy primarily towards the requirements of consolidation. They achieved higher economic growth, brought unemployment down and, not least, were also successful in terms of the aim of consolidation. Government deficits were stabilised at a low level or were actually markedly reduced. According to OECD estimates, the fiscal deficits in these countries are likely to be under 3% of GDP next year, which means that they will have achieved the reference value for the European Monetary Union.

Recent experiences in the EU countries show that a fiscal policy that pursues the aim of consolidation irrespective of considerations of economic growth, relying on the interest-rate-reducing effects of lower public borrowing, runs the risk of destabilising economic development. Clearly, an anti-cyclical fiscal policy can only be successful if investors and consumers are confident that this will not seriously exacerbate the problems of public debt in the medium term, and therefore that they need not expect rising interest rates and/or significantly higher taxes and contributions.[10] In this regard many national governments must make greater efforts to re-establish confidence, because in earlier years government deficits have often not been brought down with the necessary determination even in cyclically favourable times; in some cases this reflected political instability.[11] Yet if a restrictive fiscal policy is pursued even in a cyclical downturn, it is the demand-reducing effects that weigh particularly heavily, as they lead directly to a deterioration in sales and profit expectations, all the more so given that the EU countries – in preparation for the entry into the European Economic and Monetary Union – intend to maintain this policy over an extended period.[12] The only way to counter this would be for the monetary authorities to lend energetic support to government efforts at fiscal consolidation by cutting real interest rates, so as not only to reduce the interest bur-

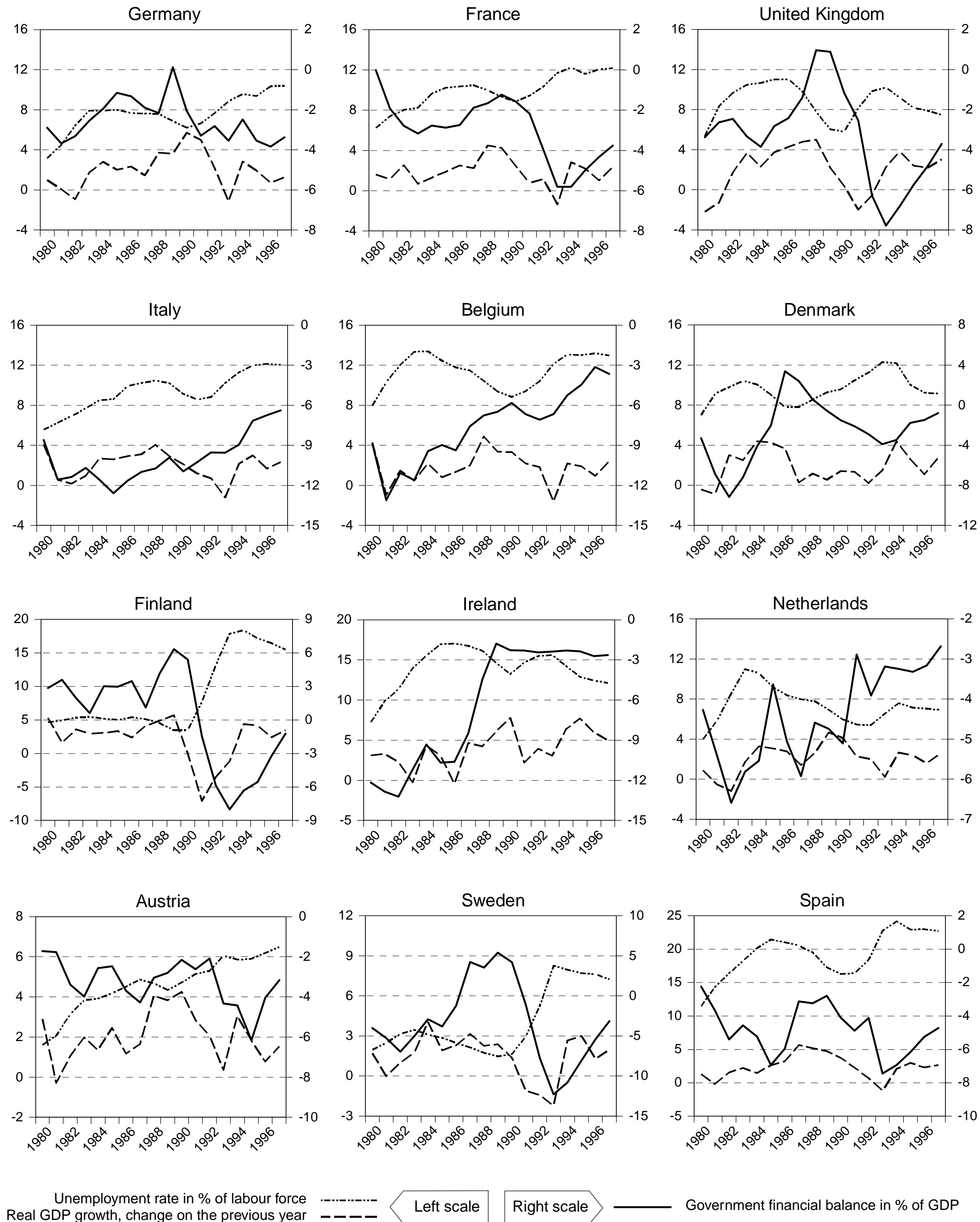
[8] Measurement of structural deficits is based on varying concepts the applicability of which remains a matter of controversy. Depending on the method used, widely divergent results are obtained for a given country, so that such figures must be interpreted with great caution. Cf. Ray Barrell, James Sefton and Jan in't Veld, Cyclically adjusted government deficits, NIESR, London 1994 (manuscript); Western industrialised countries. Business cycle at the crossroads; in: *Economic Bulletin,* vol. 33, no. 1, January 1996; OECD *Economic Outlook* 59, June 1996.

[9] The French government's plan to push the 1997 deficit below the 3% mark by means of one-off payments by France Télécom and in return to assume pension obligations is merely a short-term, cosmetic correction that in the medium term will, if anything, serve to exacerbate budgetary problems.

[10] Cf. Warwick J. McKibbin, The effects of fiscal consolidation in the OECD. The World Bank International Economics Department, *Policy Research Working Paper 1354,* Washington 1994.

[11] Cf. Willi Leibfritz, Deborah Roseveare and Paul van den Noord, op. cit. p. 21f.

Figure 1
Economic Growth, Unemployment and Budget Deficits in the EU Countries, 1980 to 1997
in %



1) From 1991 onwards east and west Germany.
Sources: OECD Economic Outlook; DIW calculations.

den on public budgets, but also to provide a strong stimulus to private investment. Yet unlike in the United States, there has been no sign of such coordination between fiscal and monetary policy in the countries of the European Union in recent years.

Bernhard Seidel

[12] Cf. William Buiter, Giancarlo Corsetti and Nouriel Roubini, Excessive deficits: sense and nonsense in the Treaty of Maastricht, *Economic Policy*, 16, 1993, pp. 58-100.