Fiscal Rules and Targets and Public Expenditure Management: Enthusiasm in the 1990s and its Aftermath

The 1990s saw an era of fiscal consolidation in industrialised countries, which struggled with fiscal deficits throughout the 1970s and 1980s. Reforms in public expenditure management, typically the introduction of fiscal rules and targets, together with favourable economic growth contributed to a significant improvement in fiscal positions. However, fiscal deficits have been increasing again since the turn of the 21st century in many OECD countries. Interestingly, some countries have been able to maintain fiscal discipline since the achievement of fiscal balance in the latter half of the 1990s. What has caused this difference? This paper derives important lessons for reform in public expenditure management from the experiences of major OECD countries, including Australia, France, Germany, Japan, the Netherlands, New Zealand, Sweden, the UK and the USA. Essentially, success in maintaining fiscal discipline lies in maintaining a firm political commitment, and strengthening expenditure management that underpins any such commitment, specifically a medium-term fiscal plan in line with fiscal rules and targets in a centralised and transparent manner. Public expenditure management reform is a cornerstone of the restructuring of public sector services, especially in welfare programs aimed at overcoming problems arising from an aging population.

Introduction

Major OECD countries improved their fiscal positions and achieved significant fiscal consolidation by the end of the 1990s. Strikingly, on average the general government fiscal balance of OECD countries turned into a surplus in 2000. Several factors were involved in this strengthening. Economic growth was, of course, important but it did not explain the whole picture. A distinctive character of fiscal adjustment in 1990s was that a large number of countries made efforts to reform their budgeting systems and institutions, typically by the introduction of fiscal rules and targets. The Maastricht Treaty criterion of restricting budget deficits to 3 per cent or less of GDP highlighted this. Furthermore, several countries such as Sweden overhauled their budgeting and public expenditure management, challenging not only the introduction of fiscal rules but also the political decision-making process involved in budgeting.

However, budget deficits appear again in most OECD countries at the turn of the twenty-first century. Fiscal rules and institutions introduced in the 1990s are now under the stringent stress testing fiscal performance. Why didn’t fiscal rules and institutions stop fiscal deterioration in 2000 and beyond?