

No. 10-03
January 2010

WORKING PAPER

**THE FACTORS AND MOTIVATIONS OF FISCAL STABILITY:
A Comparative Analysis of 26 Countries**

By Christina Forsberg, Stefanie Haeffele-Balch, and Maurice McTigue

MERCATUS CENTER
George Mason University

The ideas presented in this research are the authors' and do not represent official positions
of the Mercatus Center at George Mason University.

**THE FACTORS AND MOTIVATIONS OF FISCAL STABILITY:
A Comparative Analysis of 26 Countries**

By Christina Forsberg, Stefanie Haeffele-Balch, and Maurice McTigue

Executive Summary

There has been a rising academic debate on the sustainability of deficit spending and accumulated debt in governments across the globe. This correlates with a growing concern that excessive government deficits and accumulated debt will lead to unstable financial environments and a devalued quality of life for future generations. Varying economies with varying fiscal behavior have increased incentives to work toward more responsible fiscal behavior through reining in deficit spending and debt accumulation. We seek to understand the process these economies undertook, the procedures they used, and the resulting effectiveness of those procedures on achieving fiscal stability. This paper takes a broad, case-study view of 26 countries and some of the plausible factors and motivations that have led them to aim for fiscal prudence. While case studies like this cannot be definitive on causation, they are certainly suggestive. We look for policy reforms that may cause better long-run fiscal performance.

The countries were chosen based on their large economies (having \$100 million GDP or greater), exclusive of any strongly unique budget characteristics, and for their availability of reliable data. As a result, all of the countries selected are democracies and relatively free economies. The time frame of 1980 to 2007 was chosen and data was gathered from three main sources: The World Bank, the International Monetary Fund, and the Organisation of Economic Cooperation and Development. The measures used include total central government debt as percent of GDP, the budget balance or general government balance as percent of GDP (total revenue minus total expenditure divided by GDP), dates when various fiscal stability rules were passed (specifically focusing on budget targets and expenditure limits and excluding general budget and reporting methods). Each country analysis includes a graph demonstrating these measures over the time period selected.

Additionally, we look at four main political factors that we believe may be of significance in achieving fiscal stability: fiscal stability legislation, political structure, public accounting methods, and transparency. Fiscal stability legislation, especially budget targets and spending limits, are often present in countries trying to achieve fiscal balance. Varying fiscal legislation, reform, and commitment can be affected by differing government systems and their political climates. Accounting and budgeting frameworks that are structured on the principles of accrual build creditability and transparency and may increase the likelihood of sustainable fiscal stability by forcing policy makers to look at and deal with future assets and liabilities.

Our comparative analysis puts countries into one of three categories (“Success!,” “Not Quite,” and “Not Close”) based on whether they meet the commonly used measures we’ve selected for fiscal stability in an economy’s quest for fiscal responsibility. In order to determine the fiscal stability outcome for our countries, we have adopted guidelines established by the European Union’s (EU) Maastricht Treaty and a time requirement of ten consecutive years of compliance.

The Stability and Growth Pact within the Maastricht Treaty establishes limits on the general government fiscal deficits to a maximum of 3 percent of GDP and on the general government debt to a maximum of 60 percent of GDP. These budget balance and debt targets were agreed and implemented by all members of the European Union as a sophisticated benchmark of fiscal stability. A target of 3 percent may be a reasonable goal if long-run real growth is expected to be around 3 percent for as long as the deficit grows at the same rate as the economy, it should not ever outgrow the economy. Therefore, “Success!” represents compliance with both the deficit and debt guidelines for a time span of ten years or greater. “Not Quite” covers countries that have achieved a ten-year run of success for their debt or budget balance but were unable to maintain both for the same period of ten years. “Not Close” categorizes countries that do not meet our criteria for either budget balance and debt level for the any consecutive ten-year time span.

Our analysis shows that the countries in the “Success!” category include the Netherlands, Ireland, and Finland from the EU, as well as Canada, South Korea, Australia, Switzerland, Hong Kong, and New Zealand. The countries within the “Not Quite” category include the United Kingdom, France, Spain, Belgium, Sweden, Austria, Denmark, Poland, and Czech Republic from the EU, and the United States, Japan, Brazil, and India. Finally, the “Not Close” countries are Italy, Greece, Portugal, and Hungary from the EU.

Our conclusions are as follows. For EU countries, there has been a general shift towards fiscally balanced budgets in light of the Stability and Growth Pact. Such results lead to the question as to whether the numerical targets implemented ultimately determine the results of fiscal stability. If the Growth and Stability Pact had focused on a target of 1 percent instead of 3 percent, would there have been a larger trend towards government budget balance? Along these lines, countries that have implemented their own rules appear to be more fiscally disciplined than others, EU member and non-member countries alike.

Additionally, the implementation of accrual accounting and budgeting is a major indicator of fiscal prudence. Finally, we conclude that countries achieving “Success!” tend to either (1) have a history of stability and transparency or (2) have faced some crisis which motivated fiscal stability and other government reform. This research has illuminated the fact that countries which are making reforms in accounting and reevaluating the roles of government (to respond to a national crisis or to earn a competitive edge) have been able to achieve and sustain fiscal stability.

Table of Contents

I.	Introduction.....	1
II.	Literature Review.....	3
	A. The Use and Value of Fiscal Stability.....	3
	B. The Use and Value of Fiscal Rules.....	5
	C. Factors Associated with Fiscal Stability.....	7
	D. Summary.....	8
III.	Explanation of research methodology.....	8
	A. Country Selection.....	9
	B. Data Selection, Criterion for Fiscal Stability Outcome, and Analysis Structure...10	
	C. Country Background and Factors of Interest.....	13
IV.	Individual Country Analysis.....	15
	A. European Union Member Countries.....	15
	United Kingdom – Not Quite.....	16
	France – Not Quite.....	17
	Italy – Not Close.....	18
	Spain – Not Quite.....	19
	Netherlands – Success.....	20
	Belgium – Not Quite.....	21
	Sweden – Not Quite.....	22
	Austria – Not Quite.....	23
	Greece – Not Close.....	24
	Denmark – Not Quite.....	25
	Ireland – Success.....	26
	Finland – Success.....	27
	Portugal – Not Close.....	28
	B. Post-Communist European Union Member Countries.....	29
	Poland – Not Quite.....	30
	Czech Republic – Not Quite.....	31
	Hungary – Not Close.....	32
	C. Non-European Union Member Countries.....	33
	United States – Not Quite.....	34
	Japan – Not Quite.....	35
	Canada – Success.....	36
	Brazil – Not Quite.....	37
	India – Not Quite.....	38
	Republic of Korea (South Korea) – Success.....	39
	Australia – Success.....	40
	Switzerland – Success.....	41
	Hong Kong (China) – Success.....	42
	New Zealand – Success.....	43
V.	Conclusion.....	44
	A. Summary of Individual Country Analysis.....	44
	B. Comparison to Existing Literature.....	49
	C. Implications.....	50

The Factors and Motivations of Fiscal Stability: A Comparative Analysis of 26 Countries

By Christina Forsberg, Stefanie Haeffele-Balch,* and Maurice McTigue**

*What is prudence in the conduct of every private family can
scarce be folly in that of a great kingdom.*

Adam Smith¹

I. Introduction

There has been a rising academic debate on the sustainability of deficit spending and accumulated debt in governments across the globe.² This correlates with a growing concern that excessive government deficits and accumulated debt will lead to unstable financial environments and a devalued quality of life for future generations.³ According to an Organisation for Economic Cooperation and Development (OECD) report on fiscal sustainability, “by the early 1990s, the problem of unsustainability had been widely recognized and prompted fiscal consolidation to bring debt dynamics under control.”⁴ In response, many countries have implemented reforms on budget practices, particularly in regards to controlling expenditures. In some instances, such reforms have led to declining budget deficits.⁵

The establishment and commitment to prudent deficits and reduced debt, along with accountability in budget practices, are elements of fiscal responsibility. Although a judgment of fiscally responsible behavior will differ from economy to economy depending on the circumstances of the time, the culture of the society, and other factors, it might be described as prudent decision-making on debt, deficits, and the size of government as a share of GDP. This

* Christina Forsberg and Stefanie Haeffele-Balch are graduate students in economics at George Mason University and graduate student fellows in the Government Accountability Project and the Regulatory Studies Program at the Mercatus Center at George Mason University. The authors would like to thank scholars Garret Jones, Jerry Ellig, and Richard Williams for their helpful comments and advice during the writing process.

** The Honorable Maurice McTigue is the Vice President, the Director of the Government Accountability Project, and a Distinguished Visiting Scholar at the Mercatus Center following an illustrious career as a New Zealand Member of Parliament, Cabinet Minister, and Ambassador. Mr. McTigue led an ambitious and extremely successful effort to restructure New Zealand's public sector and to revitalize its stagnant economy in the 1984-94 period and is sharing the lessons of his practical experience with policy makers in the United States.

¹ Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Methuen & Co., Ltd., 1904), Library of Economics and Liberty, IV.2.12. <http://www.econlib.org/library/Smith/smWN.html>.

² See the literature review within this analysis for the academic discussion of this topic, as well as a brief look at public perception of deficit spending and debt.

³ According to the OECD, “A set of policies is sustainable if a borrower is expected to be able to continue servicing its debt without an unrealistically large future correction to the balance of income and expenditure.”

<http://stats.oecd.org/glossary/detail.asp?ID=7293>.

⁴ “IV. Fiscal Sustainability: The Contribution of Fiscal Rules,” *OECD Economic Outlook 72*, (2002),

<http://www.oecd.org/dataoecd/6/2/2483962.pdf>. [hereafter: OECD 2002]

⁵ Chan, James L. and Chen Xiaoyue, eds., “Models of Public Budgeting and Accounting and Reform,” *OECD Journal on Budgeting*, Vol. 2, Sup. 1. (2002), <http://www.oecd.org/dataoecd/30/0/33684121.pdf>. [hereafter: OECD Reform 2002] Many developed countries are members of the OECD, for which this statement is referring.

would be developed in an environment that would aid the economy in the immediate future without producing medium- and long-term obstacles that would prejudice future growth and prosperity. Therefore, we will not try to define fiscal responsibility—or the measures of that responsibility—to compare economies across countries or states within countries but rather will choose some commonly used measures for fiscal stability in an economy’s quest for fiscal responsibility. The measures of fiscal stability that will be implemented in this paper will try to incorporate (1) the general desire for reduced or balanced deficits, and (2) manageable levels of debt as a share of the whole economy, while not passing judgment on what is fiscally responsible.

Where countries have implemented fiscal rules to control deficit spending and reduce debt, the rules have varied in stringency and structure. The rules vary from national to local levels and from specific target mechanisms to general fiscal stability definitions. Some rules are more expenditure-oriented while others have overall budget balance objectives. George Kopits, in an IMF study, summarized that “Anglo-Saxon countries place primary emphasis on transparency (Australia, Canadian provinces, New Zealand, United Kingdom), where continental Europe (EMU Stability and Growth Pact, Switzerland’s proposal) relies far more on numerical [targets and limits as] performance indicators.”⁶

It is clear that many countries have been successful in achieving periods of fiscal stability, both with and without fiscal rules. Yet, for a variety of reasons, it is unclear whether fiscal stability legislation necessarily leads to success at controlling deficits and debt. Kopits concluded three lessons on the usefulness of fiscal rules:

First, governments with a strong reputation of fiscal prudence do not need to be constrained by rules. Second, in countries where such a reputation is lacking, fiscal rules can provide a useful policy framework and, over time, contribute to stability and growth. Third, to enhance their usefulness, fiscal rules need to be well designed at national and subnational levels of government, combining simplicity, flexibility, and growth-oriented criteria; furthermore, they must be implemented in a transparent manner, with the support of an appropriate institutional infrastructure (especially as regards to the budgetary process and surveillance mechanism) and following careful preparation and convergence.⁷

In addition to fiscal rules, various other factors may lead to fiscal stability. For example, government structures and political climates may affect budget discipline. The goal of this paper is to begin identifying some of the factors that may cause or correlate with the sustainability of

⁶ George Kopits, “Fiscal Rules: Useful Policy Framework or Unnecessary Ornament,” *IMF Working Paper*, (September 2001): 5. <http://www.imf.org/external/pubs/cat/longres.cfm?sk=15370.0>. [hereafter: Kopits 2001]

⁷ *Ibid*, 19.

fiscal stability. Determining direct causation, instead of correlation, would require a more in-depth study than what we have attempted in this paper.

II. Literature Review

There is a substantial body of literature on this topic. The elements of fiscal stability and the meaning and importance of deficits and debt are widely discussed. The structure, implementation, and necessity of budget laws and fiscal rules are also heavily debated. We use the existing literature to hypothesize and analyze which factors may be responsible for helping countries achieve fiscal stability.

A. The Use and Value of Fiscal Stability

One general macroeconomic view that deficit spending and debt is an acceptable government practice as long as the country remains fiscally solvent.⁸ However, problems with solvency are compounded when lenders and citizens become affected by large deficits and accumulated debt. Given the close relationship between deficits and rising debt levels, “high fiscal deficits provide *prima facie* evidence that there could be a potentially serious debt problem on the way.”⁹ Studies looking at the sustainability and effects of prolonged deficit spending have found correlations between government deficits and high interest rates, reduced per capita income, and negative effects on growth.¹⁰ For example, Laura Razzolini and William Shughart used panel data within the U.S. from 1967 through 1992 and found that deficits and taxes reduce the rate of income growth in a given state.¹¹ “The high level of debt accumulated in most advanced economies from the mid-seventies to mid-nineties has brought sustainability and fiscal consolidation to the forefront of economic authorities' concerns.”¹² Additionally, high levels of deficits and debt can have a potentially damaging effect on economic growth. Therefore, many economies have turned towards combating these problems through fiscal stability reforms such as balanced budget goals.

Fiscal stability deals with a government's ability to maintain an appropriate level of deficit spending and the subsequent accumulation of debt. The level of debt accumulated influences current investors as well as current and future taxpayers. According to the OECD, debt is a particularly good indicator of fiscal solvency in countries where the government includes future

⁸ Andrew B. Abel, Ben S. Bernanke, and Dean Croushore, *Macroeconomics*, Sixth Edition, New York: Pearson Addison Wesley (2008), Chapter 15 (573-610).

⁹ Willi Leibfritz, Deborah Roseveare and Paul van den Noord, “Fiscal Policy, Government Debt and Economic Performance,” *OECD Economics Department Working Papers*, No. 144 (1994): 64. <http://fiordiliji.sourceoecd.org/vl=24593401/cl=19/nw=1/rpsv/cgi-bin/wppdf?file=5lgsjhvj879q.pdf>. [hereafter: Leibfritz, Roseveare, and van den Noord 1994].

¹⁰ Javier Andrés and Rafael Doménech, “Fiscal Rules and Macroeconomic Stability,” *Hacienda Pública Española*, 176 (2005), 11-12. [hereafter: Andrés and Doménech 2005]

¹¹ Laura Razzolini and William F. Shughart II, “On the (relative) unimportance of a balanced budget,” *Public Choice*, Vol. 90, No. 1-4 (March 1997), 215.

¹² Andrés and Doménech 2005, 2.

contracts and liabilities within their measurement of debt.¹³ These elements are incorporated into budgeting through accrual accounting methods which track expected future revenues and liabilities and are the standard accounting method used by the global business sector. By definition, accrual-based budgeting requires that “net present fiscal cost associated with various government programs and contingent liabilities be included in budget documents.”¹⁴ Yet, many countries use cash-based accounting methods instead of accrual, which only looks at current revenues and liabilities, and as a result can present debt levels that are misleading or incomplete. For example, the United States fails to include promised Social Security and Medicare benefits to those who have yet to reach the age of sixty-five in their measures of debt.¹⁵ A countries’ lack of a combined accrual accounting and accrual budgeting may make indicators such as net debt distort the well-being of a country’s fiscal situation. If a government can provide complete information about its fully realized financial assets and liabilities, then net debt gives a more accurate picture of the true solvency of the country.

Determining whether a country is fiscally stable is not a textbook exercise. For example, the OECD suggests that, “no single indicator captures all the information about the fiscal situation perfectly but evaluating the situation by looking at a range of them should help to counterbalance the short-comings of each one.”¹⁶ Deciding how much weight or emphasis should be given to different indicators is an extremely difficult task and may not be the same for every country. Each country may find itself in a distinctive situation, and one underlying problem may become dominant, such as an exorbitant amount of debt.¹⁷ However, a relatively balanced fiscal deficit may be a poor indicator. For example, overall tax and expenditure ratios could be balanced but so high that incentives to work and save may be significantly distorted. Milton Friedman, in *Tyranny of the Status Quo*, postulated that, “taxes and spending are the real culprits, not deficits and debt.”¹⁸ James Buchanan and Richard Wagner believe fiscal stability requires that the “government should not spend without imposing taxes; and government should not place future generations in bondage by deficit financing of public outlays designed to provide temporary and short-lived benefits” and advocate for a constitutional amendment that would ensure balanced budgets.¹⁹

Countries that focus on reducing deficits and debt should keep in mind that certain measures that appear to achieve fiscal stability could do so at the risk of resulting lower economic growth.

¹³ Leibfritz, Roseveare, and van den Noord 1994, 68.

¹⁴ Hana Polackova, “Government Contingent Liabilities: A Hidden Risk to Fiscal Stability,” *The World Bank*: 12.

¹⁵ *I.O.U.S.A.*, DVD, directed by Patrick Creadon (2008; USA: PBS (DIRECT)).

¹⁶ Leibfritz, Roseveare, and van den Noord 1994, 63.

¹⁷ *Ibid*, 63.

¹⁸ Milton Friedman and Rose Friedman, *Tyranny of the Status Quo* (San Diego: Harcourt Brace Jovanovich, 1984), 27.

¹⁹ James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes*, (Indianapolis, IN: Liberty Fund, Inc., 1999), Library of Economics and Liberty, 8.1.1, <http://www.econlib.org/library/Buchanan/buchCv8c1.html>. [hereafter: Buchanan and Wagner 1999]

Improvements that motivate governments toward fiscal stability without sacrificing higher economic growth are likely to include transparent reporting of spending, revenues, and debt and the reduction of debt in order to ensure lower tax rates and liabilities for future generations. Fortunately, U.S. citizens appear to be interested in these measures. Blinder and Holtz-Eakin found in a survey of U.S. citizens that “respondents divided almost evenly among three general arguments in favor [of a balanced budget]: that nations (like people) should ‘live within their means,’ that balancing the budget is anti-inflationary, and that balancing the budget is a good way to cut wasteful government programs.”²⁰

B. The Use and Value of Fiscal Rules

A variety of rules and reforms have been implemented in economies throughout the world as a result of growing concerns about both government deficit spending and resultant accumulated debt. Rules can propose targets for deficit and debt levels, encourage balanced budgets and debt reduction, enforce limits on government expenditure, or a combination of the above. A number of studies have analyzed the effectiveness of these rules and have made recommendations on which ones have the most potential for success.

Buchanan and Wagner use the theoretical lens of public choice to conclude that rules are needed in order to restrain the politicians’ incentive to engage in deficit spending.²¹ The argument goes that failure to adhere to these standards of fiscal stability would result in politicians and policy makers appearing to be irresponsible in the eyes of citizens, leaving them vulnerable during elections and reappointments. Along these lines, Barry Eichengreen found that rules can be used to remind governments to steer clear of policies that can endanger financial stability.²² Yet, the ability to achieve fiscal stability is not guaranteed by passing a rule. As noted by David Primo, preexisting rules and incentives can inhibit the development of fiscal stability reforms designed and implemented in the political process.²³ This literature points out that while fiscal rules can be effective at restraining political incentives, their existence does not guarantee success.

One set of rules we can observe and analyze is found within the structure of the European Union (EU). The Stability and Growth Pact, within the Maastricht Treaty, sets strict numerical targets for deficit spending and debt for European Union members. Enacted in 1992, these targets were followed for a few years, yet Javier Andrés and Rafael Doménech found that most governments have begun to neglect them.²⁴ Eichengreen observes that many countries are now violating the rules established by the Growth and Stability Pact because they lack enforcement mechanisms,

²⁰ Alan S. Blinder and Douglas Holtz-Eakin, “Public Opinion and the Balanced Budget,” *The American Economic Review*, Vol. 74, No. 2 (May, 1984): 147. <http://www.jstor.org/stable/1816345>.

²¹ Buchanan and Wagner 1999.

²² Barry Eichengreen, “Institutions for Fiscal Stability,” *Working Paper PEIF-6*, (May 3, 2003): 3. [hereafter: Eichengreen 2003]

²³ David M. Primo, *Rules and Restraint*, (Chicago: The University of Chicago Press, 2007), 21. [hereafter: Primo 2007]

²⁴ Andrés and Doménech 2005, 30-31.

or because their initial reforms were weak, even though some progress toward fiscal stability was made in the past.²⁵ Thus, many countries in the EU have now found themselves struggling to consistently follow the pact.

In fact, in analyzing the EU's policies, it is not clear that quantitative targets will necessarily lead to better outcomes. Alberto Alesina and Roberto Perotti argue that quantitative targets can counterproductively increase the incentives for nontransparent budgeting and accounting which undermines the original intent of the targets.²⁶ On the other hand, Paolo Manasse found that "deficit ceilings may have some success in achieving fiscal discipline, particularly when limits are tight and expected sanctions are high, albeit at a large welfare cost." He recommends that such rules "should penalize deficits *and* reward surpluses, and should apply *independently* of the state of the economy."²⁷ Other academic suggestions to improve the Stability and Growth Pact include improving fiscal institutions through reform of EU policies²⁸ and increasing transparency within the budget process.²⁹

Additional studies have outlined the style of rules that will have the most potential for sustained success. Through his analysis on United States budget reform, Robert Inman concluded that, "effective deficit constraints must use *ex post* deficit accounting, must be constitutionally grounded, must be enforced by an open and politically independent review panel or court with significant sanctions for violations, and [must be] costly to amend."³⁰ Primo emphasizes that budget rules are effective when "they are designed to account for the larger institutional environment in which they operate and are attached to credible enforcement mechanisms."³¹ Kopits notes that rules should be transparent and smartly designed in order to be useful.³² And some scholars, such as Milton Friedman, are proponents of expenditure limits as a proportion of the economy instead of balanced budget rules. Friedman suggests that when government expenditures are restrained, deficits and surpluses will emerge over time (with lower or higher national income, respectively) but will lead to overall fiscal stability.³³ These varying stances highlight the fact that when it comes to the use of fiscal stability rules, there is always a trade-off between the simplicity of a flexible rule and the comprehensiveness of a strict rule, for there are benefits and disadvantages to both.³⁴

²⁵ Eichengreen 2003, 3.

²⁶ Alberto Alesina and Roberto Perotti, "Fiscal Discipline and the Budget Process," *The American Economic Review*, Vol. 86, No. 2 (May, 1996): 402. <http://www.jstor.org/stable/2118160>. [hereafter: Alesina and Perotti 1996]

²⁷ Paolo Manasse, "Deficit Limits and Fiscal Rules for Dummies," *IMF Working Paper*, (May 2005): 13.

²⁸ Eichengreen 2003, 7.

²⁹ Alesina and Perotti 1996, 404.

³⁰ *Ex post* deficit accounting requires the budget be balanced at the end of the fiscal year. Robert P. Inman, "Do Balanced Budget Rules Work? U.S. Experience and Possible Lessons for the EMU," *NBER Working Paper*, No. W5838 (February 1998): ii. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=225624.

³¹ Primo 2007, 131.

³² Kopits 2001

³³ Milton Friedman, "A Monetary and Fiscal Framework for Economic Stability," *The American Economic Review*, Vol. 38, No. 3 (Jun., 1948), <http://www.jstor.org/stable/1810624>.

³⁴ Leibfritz, Roseveare, and van den Noord 1994.

Moreover, government structure can compound the effectiveness, or lack thereof, of fiscal rules. The structure of government within a country has an effect on its ability to pass valuable and enforceable legislation. Highlighted in the work of Carlos Santiso, “political institutions and institutional arrangements have a decisive influence on economic performance and fiscal responsibility.” For example, “parliaments' role in the governance of the budget is [...] subdued and often dysfunctional, partly as a result of executive predominance, but also because of legislatures' own deficiencies. Parliaments do possess a wide range of budgetary powers, but often fail to exercise them effectively or responsibly.”³⁵ Still, parliaments may do better than other government systems because they are relatively more likely to pass reforms quickly.³⁶

C. Factors Associated with Fiscal Stability

Transparency appears to be correlated fiscal stability but it is not clear which comes first. For example, full and transparent disclosure may aid government efforts to explain and implement painful fiscal adjustments, as was the case with Ireland.³⁷ Roumeen Islam reports from his research that well designed and transparently reported indicators appear to be associated with better political decisions. For example, policy makers find that information on both economic and political markets appears to be critical for economic growth.³⁸ Islam’s empirical analysis shows that countries that have better information flows, as measured by both the existence of freedom of information laws and score highly on the “transparency” index (which measures the frequency with which economic data are published), have better quality governance overall beyond fiscal matters.³⁹ In fact, “there appears to be a close relationship between better information flows and how fast economies grow.”⁴⁰ Additionally, the World Bank advises that making public fiscal data widely available can enhance economic growth.⁴¹ Yet, their empirical findings have not demonstrated causality between greater transparency and greater fiscal stability. The correlation appears to go in the opposite direction: it is possible that fiscally stable governments are more likely to advance greater transparency.⁴² It seems intuitive that fiscally stable governments have less to hide from citizens and so are more likely to share the complete budget picture with them. As indicated above, there are various views with regard to the causality between transparency and fiscal reform. Whether transparency causes reforms or vice versa, transparency can protect an environment of fiscal stability once reforms are in place.

³⁵ Carlos Santiso, “Budget Institutions and Fiscal Responsibility: Parliaments and the Political Economy of the Budget Process,” *World Bank Institute*, (January 2005), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=657663.

³⁶ *Ibid*.

³⁷ See “Ireland” on p. 27.

³⁸ Roumeen Islam, “Do More Transparent Governments Govern Better?” *World Bank Policy Research Working Paper*, No. 3077 (June 2003). [hereafter: Islam 2003]

³⁹ Islam 2003.

⁴⁰ *Ibid*, 36.

⁴¹ *Ibid*, 36.

⁴² *Ibid*, 36.

As aforementioned, one particular form of transparency which may influence fiscal stability is an accrual-based accounting system with accrual budgeting. Accrual-based budgeting and accounting make both the potential fiscal cost and hidden subsidies of contingent liabilities more transparent *ex ante*.⁴³ According to the World Bank, without accrual budgeting, governments fail to adequately consider fiscal risks in policy, such as social security: “Although [a lack of accrual budgeting] encourages governments to prepare a statement of contingent liabilities and financial risks, it generally does not require that the liabilities be included in the balance sheet and that the associated risks be evaluated and quantified.”⁴⁴

D. Summary

A renewed sense of fiscal stability has increasing importance for governments, academics, and the public and has been prompted by prolonged deficit spending and ever-growing debt in some countries. Many scholars promote the use of fiscal rules to tame spending, reduce deficits, and pay off debt. The literature reveals that such rules should be flexible, transparent, properly enforced, and accompanied with both fiscal and general institutional reform. These rules also have a higher potential of success when paired with improved government accounting methods and reporting guidelines.

III. Explanation of Research Methodology

In order to examine the conditions associated with fiscal stability, we selected a set of countries for which there was available, adequate data and case studies. Given the nature of our inquiry, we used comparative analysis to observe budget deficits, determine fiscal stability outcomes, and identify the factors that influence fiscal stability.⁴⁵ It is important to note here that we do not examine all of the factors that influence fiscal stability. For example, long-term social commitments to pensions and health care may make a considerable impact on deficits and debt, as might regulatory regimes, tax structures, defense spending, and local and global political pressure which might enhance or attenuate growth. Our focus is primarily on rules, transparency, accounting methods, and general government structures. We also do not focus on the specific effects of different types of fiscal rules and their impact on fiscal stability, although we do separate fiscal targets from expenditure limits in our study. Our goal is to provide a base of potential factors and lessons from a comparative analysis in fiscal stability from which further research and more specific analyses can build.

⁴³ Ibid, 12.

⁴⁴ Ibid, 12.

⁴⁵ Charles C Ragin, *Constructing Social Research: The Unity and Diversity of Method*, (Thousand Oaks: Pine Forge Press, 1994). [“Comparative methods are used to study configurations. A configuration is a specific combination of attributes that is common to a number of cases.” (115) “In many ways, the comparative approach lies halfway between the qualitative approach and the quantitative approach. The qualitative approach seeks in-depth knowledge of a relatively small number of cases. When the focus is on commonalities, it often narrows its scope to smaller sets of cases as it seeks to clarify their similarities. The comparative approach usually addresses more cases because of its emphasis on diversity, and it is applied to sets of cases that are clearly bounded in time and space.” (130)]

A. Country Selection

In determining our set of countries, we first focused on countries with gross domestic products (GDPs) of 100 billion USD or higher in 2007. This GDP constraint provided an initial sampling of countries that play an important role in the world economy and offer a variety of government structures and ideologies. The country set was further narrowed by eliminating countries with incomplete data sets using international databases including the World Bank, the International Monetary Fund (IMF), the Organisation for Economic Cooperation and Development (OECD), Asian Development Bank (ADB), and the Competitive Enterprise Institute (CEI). After controlling for data availability and reliability, the selected countries essentially comprise of current or upcoming OECD members.

Additionally, when picking the final set, we eliminated any countries with strongly unique characteristics in their budgets (specifically Norway and Germany) as our goal is to find common factors that affect fiscal stability. Norway was eliminated from our selection because its budget balance is heavily influenced by oil revenues, resulting in large surpluses. We also eliminated Germany because the German Unification presented distinctive circumstances which affected government balances. Our final data set includes 26 countries after eliminating countries with incomplete data and distinctive circumstances.

In our analysis, the country set is divided into three groups to which we will apply the factors we have identified as being associated with sustained fiscal stability. The groups include European Union (EU) member countries, countries that have recently transitioned from communism (in the 1990s) and are EU members, and non-EU member countries.

While it is important to have accurate and complete data for our analysis, we realize that our selection is biased towards industrialized, developed, and democratic countries, which are more likely to have a strong rule of law and be fiscally transparent and accountable. Often the availability and completeness of government data is a transparency and accountability indicator. It is probable that a country which is able and willing to provide consistent and accurate data may also be able and willing to make reforms to achieve fiscal stability. For this reason, the countries within our analysis, which have reliable and available data, may be more inclined to fiscal stability and sustainability. Therefore, our results do not necessarily extend beyond the countries that we include in our study.

B. Data Selection, Criterion for Fiscal Stability Outcome, and Analysis Structure

In looking at balanced budget characteristics, we wanted to find trends over a reasonable amount of time both before and after the prevailing time period—the 1990s—when the countries

selected appeared to be most concerned about balanced budgets. For this reason, we chose the period 1980 through 2007. This time period was selected because 2007 is the most recent year that data was available and data earlier than 1980 is less comprehensive for all of the countries considered. For countries in our selection that experienced a transition from communism after the end of the Cold War, we have chosen the time period 1990 to 2007, since that is when the transition took place (Poland, the Czech Republic, and Hungary).

The World Bank, IMF, and OECD were the three main data sources because their data was the most comprehensive and was consistent among each other. The key data includes the annual budget balance or general government balance as a percent of Gross Domestic Product (GDP). The Asian Development Bank defines the budget balance as: “[...] the difference between total revenue and total expenditure. This provides a picture of the overall financial position of the government. When the difference is positive, the fiscal position is in surplus, otherwise it is in deficit.”⁴⁶ We also look at government debt, the accumulated deficits and liabilities of government, as a percent of GDP.⁴⁷ It should be noted that debt can be measured in different ways and can include (or exclude) information on issued debt, government-owned enterprises, and state and local sectors.⁴⁸ While we attempt to use the most comprehensive and standardized debt measurements available, we realize that economies use various methods of accounting (ranging from full accrual to cash) as well as various methods of calculation and reporting of debt, therefore some of the measurements of debt may be understated. Deficit and debt data represented as percent of GDP incorporate the magnitude of both factors in relation to the size of a country’s economy. It should be noted that individual countries may define total revenue, total expenditure, and outlays in various ways. Therefore, “the data are not readily comparable across countries.”⁴⁹

We also look at fiscal stability legislation, marking the years such legislation has been passed for each country. We used the OECD and World Bank determinations of what constitutes fiscal

⁴⁶ “Technical Notes: Key Indicators of Developing Asian and Pacific Countries,” *Asian Development Bank*, (2002): 500. http://www.adb.org/Documents/Books/Key_indicators/2002/tech_notes.pdf.

⁴⁷ “The coverage of the data is limited to central government debt issuance and excludes therefore state and local government debt and social security funds.” More information can be found on: http://webnet.oecd.org/OECDStat_Metadata/ShowMetadata.ashx?Dataset=GOV_DEBT&ShowOnWeb=true&Lang=en.

⁴⁸ “Statistics are presented in a standard framework to facilitate cross-country analysis. Accompanying country notes describe the specificity of debt instruments in each country and include information on the institutional and regulatory framework as well as on selling techniques of debt instrument.” Also, “The statistics do not take into account state and local government debt and social security funds. Concepts used in the statistics differ from Maastricht definition of government debt criteria with regard to the institutional coverage and the method of calculation.” See: http://www.oecd.org/document/5/0,2340,en_2649_34487_2007685_1_1_1_1,00.html.

⁴⁹ Data and Statistics, “Frequently Asked Questions,” The World Bank, <http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,contentMDK:20541394~menuPK:1277382~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html>. [“The data are not readily comparable across regions.”]

stability legislation because of the wide variation in policies across countries.⁵⁰ Many countries use vastly different fiscal rules, so it is important to see which of them have achieved fiscal stability and if this success correlates with their individual fiscal guidelines. However, our goal for this analysis is to use a measure of fiscal stability with which to compare across countries. We do not analyze which types of rules are likely to aid fiscal stability success or apply any in-depth analysis to the array of fiscal rules in use.

In order to determine the fiscal stability outcome for our countries within the time periods we selected, we have adopted guidelines established by the Maastricht Treaty.⁵¹ The Stability and Growth Pact within the Maastricht Treaty establishes limits on the general government fiscal deficits to a maximum of 3 percent of GDP and on the general government debt to a maximum of 60 percent of GDP. These budget balance and debt targets were agreed and implemented by all members of the European Union as a sophisticated benchmark of fiscal stability. A target of 3 percent may be a reasonable goal if long-run real growth is expected to be around 3 percent for as long as the deficit grows at the same rate as the economy, it should not ever outgrow the economy. We chose a relatively long-term, although somewhat arbitrary, time span of ten years or greater as the measure of a successful period of fiscal stability.

These criteria will be used to determine whether or not each country has been successful at achieving fiscal stability between 1980 and 2007. Three categories, “Success!,” “Not Quite,” and “Not Close,” will identify the proximity of a country’s success to the criteria set forth. “Success!” will describe countries that have achieved the criteria for both a balanced budget and an appropriate level of debt for ten consecutive years in a row. While countries that maintained ten years of fiscal stability, but then lapsed in the years after, are still considered to have been a “Success!” we note their later inconsistency and instability. “Not Quite” covers countries that have achieved a ten-year run of success for their debt or budget balance but were unable to maintain both for the same period of ten years. Some countries under this category may have been able to achieve relatively stable deficit levels for a certain amount of time but did not have sustainable levels of debt or lost control altogether. An example is Japan, an economy which maintained prudent debt and deficit levels until 1993 where deficits increased substantially and debt skyrocketed due to an economic downturn and subsequent regulatory actions. “Not Close” categorizes countries that do not meet our criteria for both budget balance and debt level for the same consecutive ten-year time span. While some countries receiving a “Not Close” outcome

⁵⁰ “Country Budget Laws.” World Bank, <http://www1.worldbank.org/publicsector/pe/countrybudgetlaws.cfm>; OECD 2002, Appendix Table IV.A.1; Isabelle Joumard, Per Mathis Kongsrud, Young-sook Nam, and Robert Price, “Enhancing the effectiveness of public spending: Experience in OECD countries,” *OECD, Economics Department Working Paper*, No. 380 (2004), <http://www.oecd.org/dataoecd/12/38/34563306.pdf>.

⁵¹ “Treaty of Maastricht on European Union,” Europa, http://europa.eu/legislation_summaries/economic_and_monetary_affairs/institutional_and_economic_framework/treaties_maastricht_en.htm. [hereafter: Maastricht]

may have made recent improvements and maintained fiscal success, until a ten-year period has elapsed, they will not earn a spot in a higher category within our analysis.

A graph is included with each country analysis summarizing the actual government balances, debt levels and the results of our analysis. Each graph has the following format and data:

Red line with diamonds – The red line is the total central government debt as percent of GDP. This data is provided by the OECD, World Development Indicators (WDI), and Banco Central de Brasil.

Green line with diamonds – The green line is the budget balance or general government balance as percent of GDP (total revenue minus total expenditure divided by GDP). The data is provided by the IMF, OECD, ADB, and CEI.

Blue dots – The blue dots indicate the dates at various fiscal stability rules were passed. The legislation used in this analysis comes from the OECD⁵² and a CESifo⁵³ DICE Report⁵⁴, which focus on budget targeting and expenditure limits instead of general budget and reporting methods.

Segmented purple lines – The segmented purple lines display our fiscal stability guidelines. We use the guidelines established in the Maastricht Treaty within the Stability and Growth Pact. As aforementioned, the pact establishes limits on the general government fiscal deficit to a maximum of 3 percent of GDP and on government debt to a maximum of 60 percent of GDP.

Yellow boxes – The yellow boxes highlight the periods of successful fiscal stability for simultaneous fiscal balance and debt which lasted for at least ten years.

A visual representation of the elements of each graph is shown in the key below:

⁵² OECD 2002, Appendix Table IV.A.1

⁵³ “About Us,” The CESifo Group, <http://www.cesifo-group.de/portal/page/portal/ifoHome/f-about>. [“The CESifo Group, consisting of the Center for Economic Studies (CES), the Ifo Institute for Economic Research and the CESifo GmbH (Munich Society for the Promotion of Economic Research) is a research group unique in Europe in the area of economic research. It combines the theoretically oriented economic research of the university with the empirical work of a leading Economic research institute and places this combination in an international environment.”]

⁵⁴ “Expenditure Rules: Table 1 Rules for public expenditure, EU Countries, 2003: Basic Characteristics,” *CESifo DICE Report*, (4/2004), http://www.cesifo-group.de/portal/page/portal/DICE_Content/PUBLIC_SECTOR/PUBLIC_FINANCE/PFo6o_PUBLIC_EXPENDITURES/DR4-04-Expen-rul.pdf. [hereafter: CESifo Rules]

Key to Individual Country Graphs		
Color	Shape	Measure
		Total Central Government Debt or Net Public Debt Source: OECD, Banco Central de Brasil, WDI
		General Government Balance, Fiscal Balance, or Central Government Deficit/Surplus Source: IMF, CEI, OECD
		Fiscal Rule Source: OECD, CESifo
		Guideline - Debt Max 60% of GDP Source: Growth and Stability Pact (Maastricht Treaty - EU)
		Guideline - Deficit Max 3% of GDP Source: Growth and Stability Pact (Maastricht Treaty - EU)

C. Country Background and Factors of Interest

After the data analysis and criterion outcomes are discussed, we will provide a brief background on each country. There are four main political factors that we believe may be of significance in achieving fiscal stability: fiscal stability legislation, political climate, transparency, and public accounting methods.

Fiscal stability legislation, especially budget targets and spending limits, are often present in countries trying to achieve fiscal balance. The legislation used in this analysis are compilations from the OECD and a CESifo DICE Report and focus on budget targeting and expenditure limits instead of general budget and reporting method laws. These rules were implemented throughout the 1990s and early 2000s in an attempt to obtain and sustain fiscal stability.

The political structure (e.g. parliamentary) and the country's dispersion of power (central to federalist) are potentially important factors in reforms designed to achieve fiscal stability. Varying fiscal legislation, reform, and commitment can be affected by differing government systems and political climates. While most countries within our analysis are parliamentary, we are interested in observing the differing fiscal stability outcomes across many government systems, including democratic republics.

The use of accrual accounting and budgeting and subsequent transparency also appear to be factors leading to fiscal stability. One report suggests that accrual accounting "is an important element of the wider concept of the so called New Public Management, which aims at increased transparency, efficiency and responsibility ('accountability') of the public sector vis-à-vis the citizens."⁵⁵ Accounting and budget frameworks that are structured on the principles of accrual build credibility and transparency and may increase the likelihood of sustainable fiscal

⁵⁵ "Accrual Accounting in the Public Sector," *CESifo DICE Report*, (3/2007), http://www.cesifo-group.de/portal/page/portal/DICE_Content/PUBLIC_SECTOR/PUBLIC_FINANCE/PFo60_PUBLIC_EXPENDITURES/dicereport307-db1.pdf. [hereafter: CESifo 2007]

stability by forcing policy makers to look at and deal with future assets and liabilities. The OECD notes that in those countries that have adopted accrual accounting and accrual budgeting, the change has been associated with other public management reforms. The OECD also suggests that “practices in Australia and New Zealand have shown that the use of accruals in the budget has led to a better realization of future unfunded liabilities, better infrastructure management and a more efficient budget reallocation process.”⁵⁶

In the next section, we describe the three groups of countries (EU members, post-communist EU members, and non-EU member countries) and examine each country’s fiscal stability outcomes, legislation, and influential factors. We have purposely tried to keep our descriptions of each country short, roughly one page in length, in order to focus on the key facts and findings within our analysis in a consistently uniform fashion. The final section draws correlations from the individual comparative country analyses and discusses the implications of our findings.

⁵⁶ OECD Reform 2002.

IV. Individual Country Analysis

A. European Union Countries

European Union member countries are subject to guidelines on, but not limited to, budgeting, taxation, statistical gathering, and a developed regulatory framework. The Maastricht Treaty, established in 1992, clarifies the EU's objectives and establishes standards for member countries. The Maastricht Treaty has the following five key objectives:

1. Strengthen the democratic legitimacy of the institutions;
2. Improve the effectiveness of the institutions;
3. Establish economic and monetary union;
4. Develop the community social dimension;
5. Establish a common foreign and security policy⁵⁷

As a part of implementing some of these objectives, the Maastricht Treaty set fiscal ceilings for deficit spending, also known as government net borrowing, (3 percent of GDP) and total government debt (60 percent of GDP). A deficit target of “close to balance or surplus” was also set upon EU member countries. This fiscal rule was extended in 1997 under the Stability and Growth Pact.⁵⁸

Enforcement of deficit targeting is more stringent for prospective or newly joined countries since becoming a member of the EU requires the enactment and convergence of numerous reforms and standards. Established countries face peer pressure within the community but stronger, more credible enforcement appears to be lacking.

Member countries receive benefits through joining the community. For instance: open trade for goods, services, and labor; additional security and financial support; and a standardized currency. Yet, member countries may also face some challenges. EU policies streamline government structures, which can reduce flexibility of reform and competition between countries.

⁵⁷Maastricht.

⁵⁸ OECD 2002, Appendix Table IV.A.1.

United Kingdom

Outcome: Not Quite

The UK has not consistently had a deficit that is less than 3 percent of GDP for more than seven years.

However, the UK has maintained a debt well below the maximum limit.

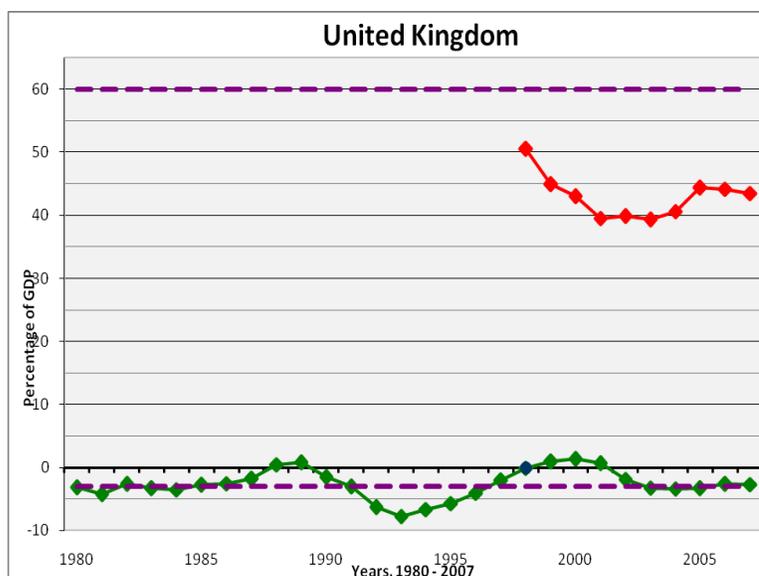
Existence of Fiscal Rules

In 1998, the UK enacted the Code for Fiscal Stability, introduced by the statute otherwise known as the 1998 Finance Act. This required

Her Majesty's Treasury to introduce into Parliament a code embodying principles of fiscal stability and required that financial statements include measurement of the government's fiscal policy objectives in relation to its commitments to the Stability and Growth Pact.⁵⁹ Other significant changes that didn't include the use of a law but were enacted by Cabinet and Treasury decisions included a "golden rule"⁶⁰ and a sustainable investment rule. The stipulations of the English golden rule were that, over the business cycle, the government will borrow only to invest and not to fund current spending.⁶¹ The sustainable investment rule requires that net debt as a proportion of GDP be held stable over the business cycle at a "prudent" level defined as net debt below 40 percent of GDP.⁶² Even though these two rules have not been officially adopted by Parliament, they are clearly defined and frequently used.

Potential Factors Influencing Fiscal Stability

The government began to go through with a major reform of the budget system in the 1990s, switching to accrual budgeting. The Government Resources and Accounts Act of 2000 completed the transformation with the switch from cash-based accounting to accrual accounting. The new public management has focused on benchmarking, outputs, and outcomes instead of inputs. Management of public expenditure has included the development of public/private partnerships and the introduction of a low inflation economic policy that is expected to result from the government giving independence to the central bank.⁶³



⁵⁹ Ian Lienert and Moo-Kyung Jung, "The Legal Framework for Budget Systems: An International Comparison," *OECD Journal on Budgeting*, Vol. 4, No. 3 (2004): 408. <http://www.oecd.org/dataoecd/48/48/35933542.pdf>. [hereafter: OECD 2004]

⁶⁰ Many countries have implemented "golden rules" but their uses and definitions vary.

⁶¹ *Ibid.*, 406. It is not clear what the government means by investing and even if government investment is a beneficial practice.

⁶² *Ibid.*

⁶³ OECD Reform 2002, 121.

France

Outcome: Not Quite

France has been unable to sustain a balanced budget according to our criteria for more than six years at a time. Still, France has consistently maintained a debt level below the maximum limit.

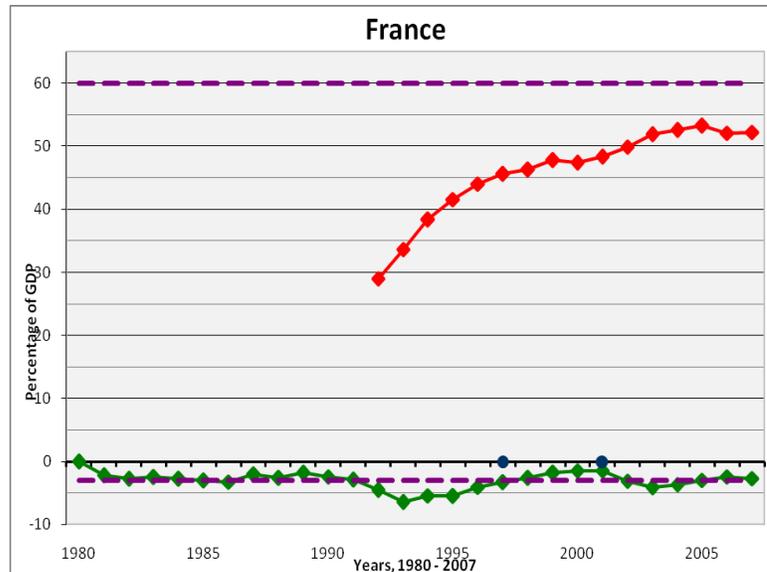
Existence of Fiscal Rules

The 2001 Organic Budget Law (LOLF) made reference to the Maastricht Treaty criteria by requiring that budgetary

projections must be drawn up “taking into consideration its European obligations,” but this is not legally binding on France.⁶⁴ Within the LOLF itself, the term “balance” isn’t clearly defined nor is a “prudent” level of debt defined, but it does lay out principles for preparation, reporting, and adoption of annual budget laws for the State. The LOLF also established accrual accounting beginning with the year 2000.⁶⁵

Potential Factors Influencing Fiscal Stability

France’s budgetary structure appears to focus more on the means rather than the outcomes.⁶⁶ There are many steps involved in exercising financial control, but less emphasis on auditing and the results of the process. On the upside, any increases in appropriations must be approved by Parliament. On a societal level, public acceptance of France’s use of financial controls is difficult to obtain simply because there appears to be a lack of public awareness regarding the necessity of financial controls.⁶⁷ The complexity of France’s financial system, however, doesn’t make it any easier for the public to comprehend. It appears that “reform successes and failures demonstrate [...that] it is largely the management of the human dimension that turns out to be crucial.”⁶⁸



⁶⁴ OECD 2004, 197.

⁶⁵ All laws and decrees available (in French) at www.legifrance.gouv.fr.

⁶⁶ OECD 2004, 209.

⁶⁷ OECD Reform 2002, 292.

⁶⁸ Ibid.

Italy

Outcome: Not Close

Prior to 1997, Italy experienced large fiscal deficits for years at 10 percent or more, but since 1992 it has worked to achieve a better balance. Italy has also faced sustained debt levels well above the maximum limit of debt to GDP.

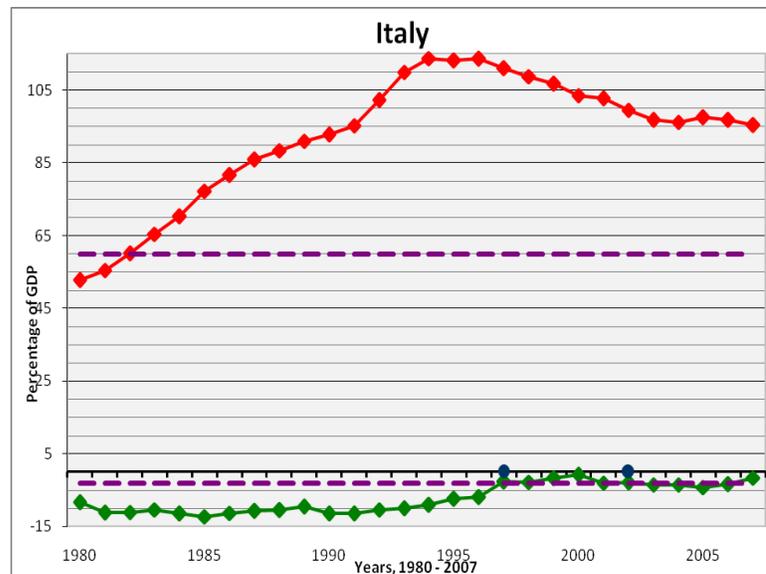
Existence of Fiscal Rules

Like other EU countries, Italy already falls under jurisdiction of the Stability and Growth Pact. In

addition to this, the “government aims at increasing the primary surplus to 5% of GDP by 2011, its level upon EMU entry, which would accelerate the projected downward trend in the debt ratio.”⁶⁹ This objective is also critical to boosting growth, which was most likely inhibited by enormous debt. Additionally, in 2002, Italy placed a nominal ceiling on expenditure growth until new legislation makes funding available again. It’s too early to tell the outcome of this recent legislation, but general government spending has been decreasing.⁷⁰

Potential Factors Influencing Fiscal Stability

Besides Italy’s practice of accrual budgeting, there is not much literature on the conditions surrounding its budget. The main components of Italy’s strategy included the dramatic increase in tax pressure, the decrease of expenditure for servicing the debt, partial reform of pensions, decreased number of public employees, and reduction in the cost of local government.⁷¹ The central government also began use of accrual accounting alongside cash-based accounting in 2000.⁷² Over time, these measures may help Italy control its deficits but the debt might prove problematic if not reduced in the long term.



⁶⁹ Alexandra Bibbee and Benoît Bellone, “Economic Survey of Italy 2007: Achieving Fiscal Sustainability,” *OECD Observer*, (2007),

http://www.oecd.org/document/28/0,3343,en_33873108_33873516_38698716_1_1_1_1,00.html.

⁷⁰ Ibid.

⁷¹ Claudio Radaelli, “Discourse and Institutional Change: the case of Italy in the Euro-Zone,” *Queen’s Papers on Europeanisation*, (2000),

http://www.qub.ac.uk/schools/SchoolofPoliticsInternationalStudiesandPhilosophy/FileStore/EuropeanisationFiles/Filetoupload_38442.en.pdf.

⁷² OECD Reform 2002, 312.

Spain

Outcome: Not Quite

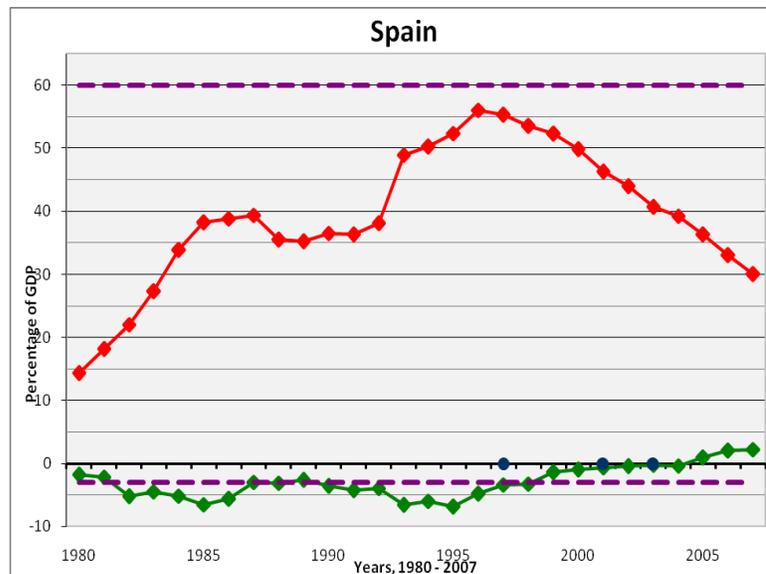
Since 1998, Spain has shrunk its deficit below the 3 percent criteria and moved into surpluses after 2004. It has succeeded in meeting the deficit criteria for eight years and remained under the debt limit continuously; it falls short of achieving both for a ten-year period.

Existence of Fiscal Rules

In 2001, the General Act on Budgetary Stability (GABS) was passed with the provisions of guiding principles for budgetary policy in the public sector, along with establishing the necessary procedures for application of the budgetary stability principle within the Stability and Growth Pact.⁷³ The law, in addition to the Organic Supplementary to the General Act on Budgetary Stability of 2001 and the General Budgetary Act of 2003 (effective as from 2005), all incorporate the principles of transparency, budget stability, performance, and efficiency.⁷⁴ In addition, GABS also requires that when the budget shows a deficit, the government is required to submit a plan to Parliament to restore the balance. This includes revenue and expenditure measures necessary to amend the imbalance over the next three budgetary years.⁷⁵ In the case of a surplus, the government will either reduce indebtedness or allocate it to the future needs of the social security system.

Potential Factors Influencing Fiscal Stability

Prior to the turn of the 21st century, the most important impetus for reform came from the administrative variables, such as administrative culture, internal control, and innovation.⁷⁶ Additionally, Spain practices both accrual budgeting and accrual accounting. Although, much of the new orientation of Spanish reform has been a result of media focus on the budget rather than financial accounting.⁷⁷



⁷³ OECD 2004, 378.

⁷⁴ Ibid, 378.

⁷⁵ Ibid, 387.

⁷⁶ OECD Reform 2002, 345.

⁷⁷ Ibid.

Netherlands

Outcome: Success!

The Netherlands is currently experiencing a strong run of fiscal stability. It has maintained a government balance within our standard since 1996 and has maintained a level of debt that is consistently below the maximum of 60 percent of GDP.

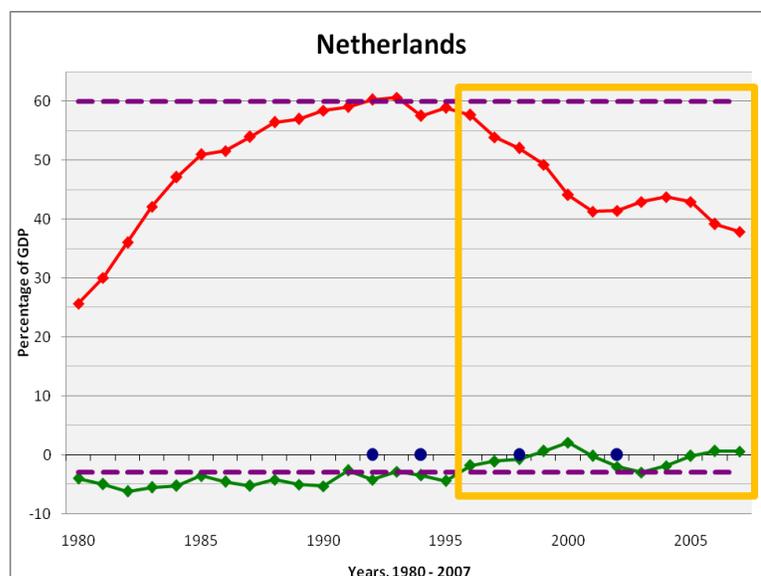
Existence of Fiscal Rules

As a founding member of the European Union, the Netherlands

has been subject to the Maastricht Treaty since 1992. Additionally, it has passed its own fiscal stability legislation, such as the Expenditure Rules and the Coalition Agreement on Multi-Year Targets, both of which were passed in 1994 and were revised in the late 1990s and early 2000s. These fiscal rules set the guidelines for cautious growth projections; restricted spending for the government, social security, and health care spending.⁷⁸

Potential Factors Influencing Fiscal Stability

A dispersed government structure makes the Netherlands a decentralized, unitary state. There are different financing options available to different levels of government, yet deficit financing is only available to the central government.⁷⁹ “The budget and accounts documents are of a high standard and provide comprehensive, timely, and reliable information on government activity in an accessible format. Fiscal data quality standards are high and the institutional framework for maintaining the integrity of the fiscal management system and data are at, or close to, best practice-level.”⁸⁰ Recently, the central government has taken steps to switch to full accrual accounting and budgeting; with a targeted completion date of 2006 but, as of 2007, a full transition had still not occurred. In addition to focusing on accounting reform, the Minister of Finance put more emphasis on policy management, outputs, and accountability which reinforces the existing government culture of openness and transparency.



⁷⁸ CESifo Rules.

⁷⁹ OECD Reform 2002, 265.

⁸⁰ “Kingdom of the Netherlands—Netherlands: Report on the Observance of Standards and Codes—Fiscal Transparency Module, and the Aide-Mémoire Regarding the Fiscal Framework,” *IMF Country Report*, No. 06/124 (March 2006): 1. <http://www.imf.org/external/pubs/ft/scr/2006/cro6124.pdf>.

Belgium

Outcome: Not Quite

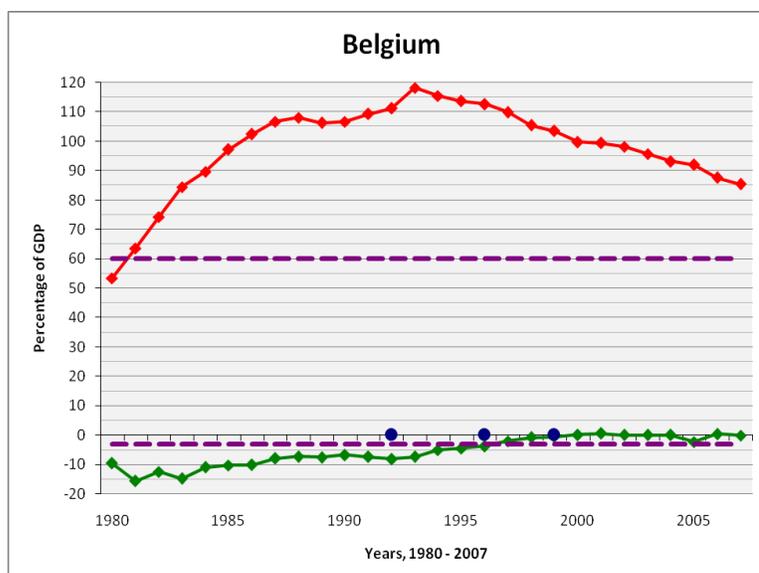
Belgium has made substantial reductions in deficit spending since 1980. From 1997 to 2007 Belgium has been successful at stabilizing deficits below 3 percent of GDP. Debt levels are a large portion of GDP but have been steadily decreasing since 1993.

Existence of Fiscal Rules

As a founding member of the European Union, Belgium has been subject to the Maastricht Treaty since its creation in 1992. In addition to EU guidelines, Belgium has had two intergovernmental treaties covering 1996 to 2002. The treaties established permissible deficits for the federal and regional governments and restricted borrowing capacity for regional and community governments.⁸¹

Potential Factors Influencing Fiscal Stability

Belgium has public sector strengths in its transparency and clarity of its budget structure. “Fiscal information is quite comprehensive and readily available to the public and there is a clear commitment to improve the timely provision of information.”⁸² On the other hand, there are some weaknesses in the Belgian system. The central government lacks a performance orientation and continues to operate with a hybrid, cash accounting system with no plans for adjusting to accrual accounting in the public sector.



⁸¹ OECD 2002, Appendix Table IV.A.1.

⁸² “Belgium: Report on Observance of Standards and Codes—Fiscal Transparency,” *IMF Country Report*, No. 08/116 (March 2008), <http://imf.org/external/pubs/ft/scr/2008/cr08116.pdf>.

Sweden

Outcome: Not Quite

Sweden has had two periods of fiscal stability, one from 1986 to 1991 and another from 2000 on. Yet, neither are for ten consecutive years, hindering a successful outcome in our analysis although a few more years of stability could produce sustained success.

Existence of Fiscal Rules

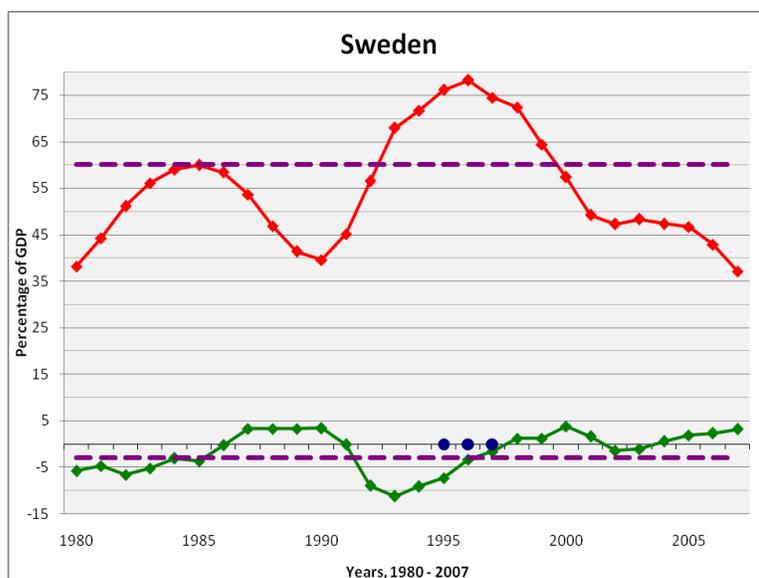
Following membership with the European Union in 1995, Sweden

has been subject to the guidelines of the Maastricht Treaty. Additionally, Sweden enacted the Fiscal Budget Act in 1996 (and revised in 1999) which targets the general government balance at surpluses of 2 percent over the business cycle.⁸³ The government also has an expenditure rule, passed in 1997, which restricts nominal expenditure and establishes a guideline to prevent expenditures from rising faster than projected nominal GDP.⁸⁴

Potential Factors Influencing Fiscal Stability

Sweden's government is a constitutional monarchy with a parliament and appointed prime minister. Their constitution consists of only four major laws: the Instrument of Government Act; the Act of Succession; the Freedom of the Press Act; and the Fundamental Law on Freedom of Expression.⁸⁵ This is a limited and unique structure of government.

Fiscal reforms were enacted in the 1990s but “performance orientated budget systems were not strengthened by law because there is a history of openness, accountability, and performance management.”⁸⁶ Indeed, fiscal stability legislation, intended to make budgeting more accountable, may not be needed when a government is open and transparent. This commitment to transparency and fiscal stability is thought to be influenced by EU membership and the Maastricht Treaty.⁸⁷ Sweden has also enhanced both its auditing and accounting framework, providing clarity to audit principles and establishing accrual accounting for some levels of the local and central governments.



⁸³ OECD 2002, Appendix Table IV.A.1.

⁸⁴ CESifo Rules.

⁸⁵ OECD 2004.

⁸⁶ Ibid, 347.

⁸⁷ Ibid, 348.

Austria

Outcome: Not Quite

Austria has had minimal deficits from 1997 to 2007. Yet, due to a major deficit in 2004 and continually increasing debt, it does not meet our criteria for ten consecutive years.

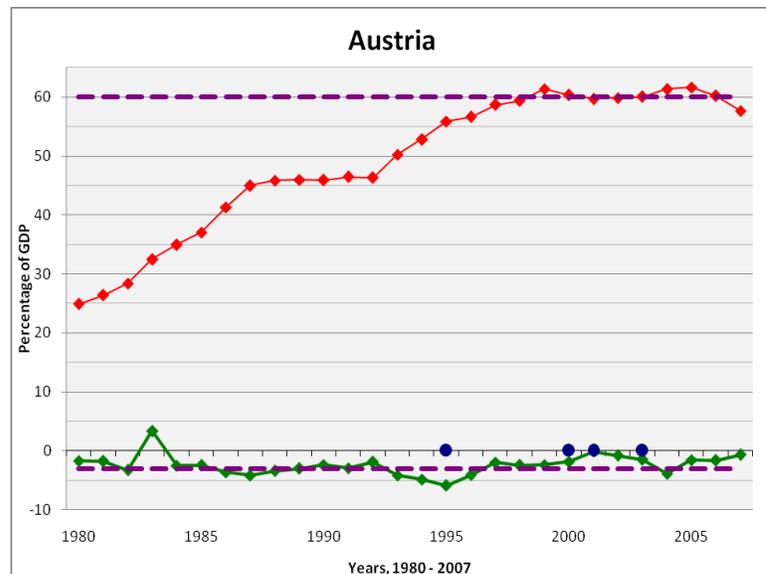
Existence of Fiscal Rules

Austria joined the European Union in 1995 and has been subject to the Maastricht Treaty and its fiscal stability provisions ever since. The country also has its own legislation consisting of the Domestic Stability Pact of 2000 and

expenditure rules passed in 2000, 2001, and 2003. The Domestic Stability Pact establishes “negotiated floors on the budget balance for each government level” and includes an escape clause in case of an economic downturn.⁸⁸ The expenditure rules apply toward administrative expenditure in the central government and budget targeting for regional and local governments.⁸⁹

Potential Factors Influencing Fiscal Stability

The government of Austria is broken into the federal, state, local, and municipal sectors. Tax revenue is levied by the federal government and then distributed to the other sectors.⁹⁰ The Austrian government has implemented a three-pronged strategy for economic policy: (1) a balanced budget over the economic cycle, (2) lowering the tax burden to less than 40 percent of GDP by 2010, and (3) a commitment to growth via fostering investment in research, education, and infrastructure.⁹¹ The government also enlisted a working group to analyze operations and propose improvements⁹² and is working on the privatization of state-owned enterprises.⁹³ Additionally, Austria has partially introduced accrual accounting but not accrual budgeting.⁹⁴



⁸⁸ OECD 2002, Appendix Table IV.A.1.

⁸⁹ CESifo Rules.

⁹⁰ “The Fiscal Equalisation System in Austria,” *BMF, Federal Ministry of Finance: 2*. http://english.bmf.gv.at/Budget/IntergovernmentalFi_252/Fiscal_Equalisation_System.pdf. [“Appr. 95% of all revenue is levied by federal revenue offices.”]

⁹¹ “Update for the period 2005 to 2008: Austrian Stability Programme,” *BMF, Federal Ministry of Finance: 2*. http://english.bmf.gv.at/EconomicPolicy/EconomicpolicyinAustria/Stabilityprogram/SP_2005-2008_EN.pdf.

⁹² *Ibid*, 15.

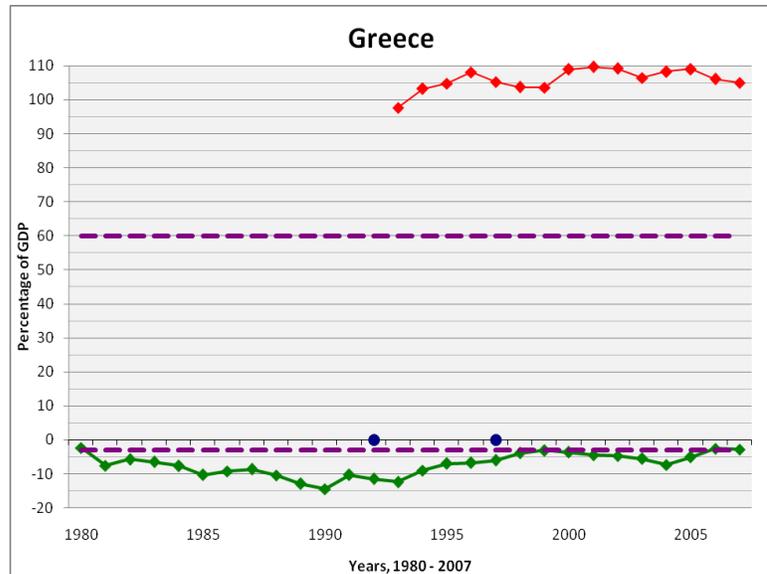
⁹³ *Ibid*, 19.

⁹⁴ CESifo 2007, 1.

Greece

Outcome: Not Close

Despite pressure from EU membership, Greece has lacked the discipline to achieve solid and consistent reductions of deficits and debt. They have made some improvements from the massive deficits of the 1980's, which linger around 3 percent of GDP in the early 2000's and since 2006. Yet, overall debt levels remain above 100 percent of GDP. More time is needed to reveal if Greece has any real determination to achieve fiscal stability.



Existence of Fiscal Rules

Greece has been a member of the EU since 1981 and thus subject to the Maastricht Treaty since its passage in 1992. The Grecian government also passed an expenditure rule in 1997 which reduces the recruitment and compensation of public employees.⁹⁵

Potential Factors Influencing Fiscal Stability

With the availability of the internet, Greece has made improvements to enhance the transparency of data and government activities through increased publications and online postings. "At the central government level Greek budget processes give assurances of integrity about fiscal data through independent audit and recently strengthened statistical reporting," yet the use of cash accounting and weaker auditing systems government-wide could benefit from further improvement.⁹⁶ Also, according to the IMF, Greece needs to modernize its financial institutions, which would further enhance transparency.⁹⁷

⁹⁵ CESifo Rules.

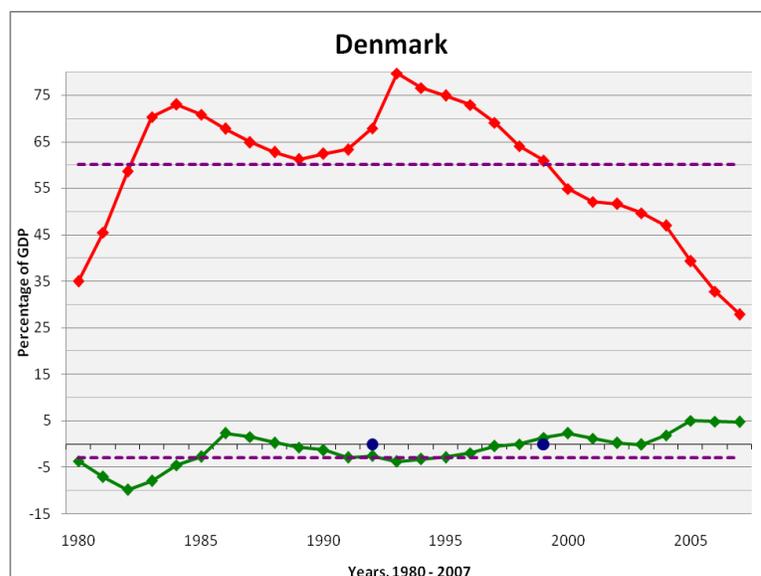
⁹⁶ "Greece: Report on Observance of Standards and Codes—Fiscal Transparency," *IMF Country Report*, No. 06/49 (February 2006): 1. <http://imf.org/external/pubs/ft/scr/2006/cr0649.pdf>.

⁹⁷ *Ibid.*

Denmark

Outcome: Not Quite

Denmark has achieved a fairly stable general government balance since 1985 with only two years below 3 percent deficit to GDP (1993 and 1994). The debt level has been steadily decreasing since 1993 and has been under 60 percent of GDP since 2000. If Denmark keeps on the same track it is likely to achieve sustained fiscal stability soon.



Existence of Fiscal Rules

As a long-standing member of the European Union (since 1973), Denmark has been under the influence of the Maastricht Treaty and its fiscal targeting under the Stability and Growth Pact since its development in 1992. Additionally, the central government passed an expenditure rule in 1999 to limit the growth of government consumption expenditure⁹⁸ by setting a target annual growth rate of 1 percent.⁹⁹

Potential Factors Influencing Fiscal Stability

Denmark's central government is a constitutional monarchy with a parliament and an appointed prime minister. The local governments play a large role in governing, with major contributions to the budget process and social goods. Regulations from the Ministry of Finance define the budget processes which "provide a legal framework for practices that were already in place."¹⁰⁰ Like Sweden, Denmark's government has a strong "history of openness, accountability, and performance management."¹⁰¹ In the spirit of accountability, audit and accounting reform has also occurred in Denmark. The central government began introducing accrual accounting and budgeting to the public sector in the early 2000s, resulting in mixed accrual and cash systems.¹⁰²

⁹⁸ Nationmaster and WDI define government consumption. "General government final consumption expenditure (formerly general government consumption) includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditures on national defense and security, but excludes government military expenditures that are part of government capital formation."
http://www.nationmaster.com/graph/gov_gen_gov_fin_con_exp_cur_us-final-consumption-expenditure-current-us#definition.

⁹⁹ CESifo Rules.

¹⁰⁰ OECD 2004, 344-350.

¹⁰¹ Ibid, 347.

¹⁰² CESifo 2007.

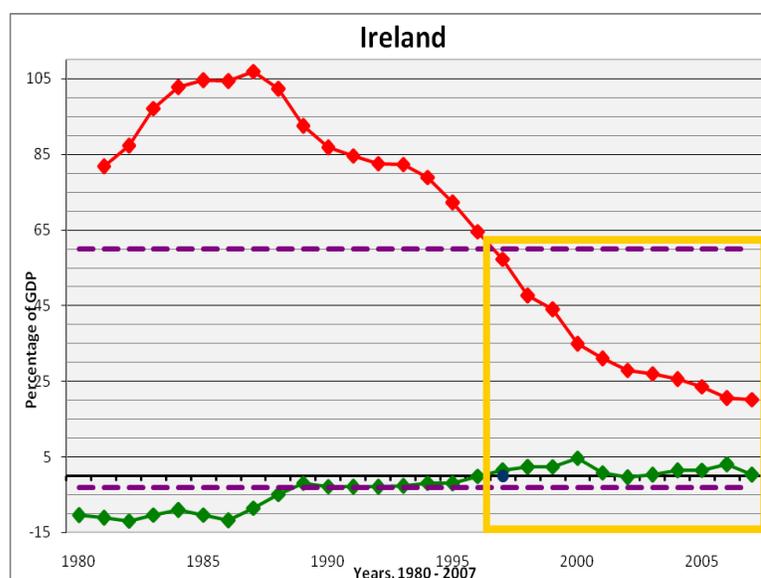
Ireland

Outcome: Success!

Ireland has come a long way since 1980. Deficits as a percent of GDP wobbled around 10 percent until they shrank dramatically from 1986 to 1989. Ireland fell below the debt limit and achieved sustained fiscal balance and surpluses since 1997.

Existence of Fiscal Rules

Besides the guidelines of the Stability and Growth Pact, which may have been one of the factors leading Ireland to shape up its government fiscal balance, Ireland has not passed major fiscal legislation.



Potential Factors Influencing Fiscal Stability

The OECD survey may overestimate the role of foreign investment and labor supply in Ireland, while at the same time it underestimates the role of fiscal policy in the economic recovery.¹⁰³ The essential and general lesson of Ireland's economic and fiscal overhaul is that the longer adjustment is delayed, the more painful it becomes.¹⁰⁴ The following factors appear to contribute to Ireland's success: "(1) The establishment of fiscal common sense as an essential ingredient of public policy; (2) The establishment, through the partnership process, of the fact that moderation in taxation and in wage development has positive outcomes for employment levels; [and] (3) The emphasis on human resource development as a tool of adjustment."¹⁰⁵ The country developed a 'social partnership model' of wage development between government and trade unions, launched roundtable discussions of the issues, and worked towards strengthening cost competitiveness while easing tensions between trade unions and employers.¹⁰⁶ The OECD concludes that the benefit of human resource development and strengthening the skills of Ireland's workforce increased Ireland's attractiveness to foreign investors.¹⁰⁷ Ireland also uses accrual accounting.

¹⁰³ McAleese, Dermot, "Ireland's Economic Boom: the True Causes," *OECD Observer*,

http://www.oecdobserver.org/news/fullstory.php/aid/164/Ireland_s_economic_boom:_the_true_causes.html.

¹⁰⁴ Dukes, Alan, "Chasing the Celtic Tiger: Is the Irish Miracle possible in Central, Eastern and Southeastern Europe?" *CROSSROADS The Macedonian Foreign Policy Journal*, Issue: 02 / 2007: 121-129. [Found on www.cceol.com.]

¹⁰⁵ *Ibid*, 128.

¹⁰⁶ *Ibid*.

¹⁰⁷ "Economic Survey of Ireland 2006." *OECD Member Economics*,

http://www.oecd.org/document/48/0,3343,en_2649_34569_36157872_1_1_1_1,00.html. It should be noted that, the results from Ireland's reforms may have unintended consequences that have not yet been seen or evaluated.

Finland

Outcome: Success!

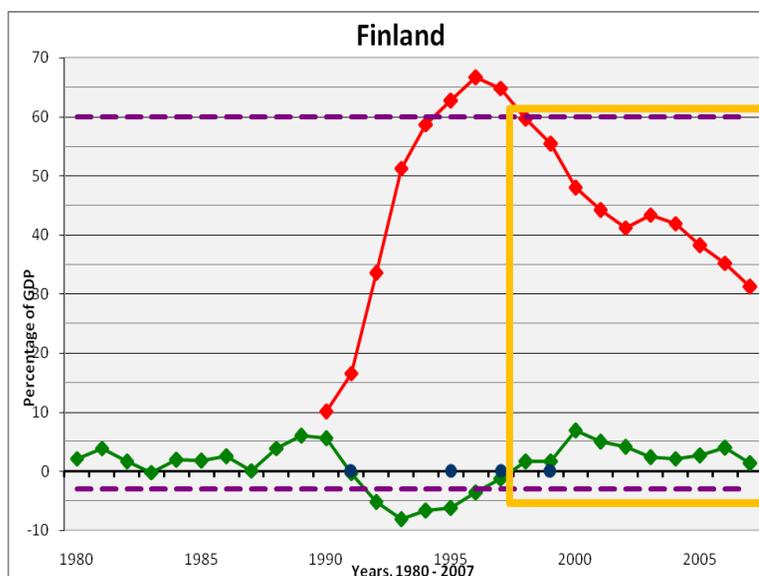
Finland ran deficits only during the period of 1992-1996.

Otherwise, Finland has fared very well in sustaining fiscal balance and even achieving consistent surpluses. For this reason, Finland meets the criteria of a successful, fiscally balanced country.

Existence of Fiscal Rules

Like other EU countries, Finland must comply with the targets

established by the Stability and Growth Pact. In addition to this legislation, Finland also passed spending limits in 1991, which were then amended in 1995 and again in 1999.



Potential Factors Influencing Fiscal Stability

In the 1990s, Finland established public sector accrual accounting in its central and sub-central levels of government.¹⁰⁸ “Like other Nordic countries, Finland has a large public sector, meaning that it has given a big promise to all citizens concerning their welfare.”¹⁰⁹ In order to achieve fiscal surpluses, tax revenues have been more than compensating for final consumption expenditures, but the government’s reported balance doesn’t take into account future obligations to the population. Because of this, private pension and health insurance is rather insignificant by current measurement.¹¹⁰ Therefore, expected changes in public services and transfers could potentially be very destructive.¹¹¹ It is expected in the future that Finland’s surpluses will be difficult to maintain without decreasing public expenditures or increasing the tax rate. Given the aging population in Finland, and their expectation that promises will be met, it’s likely that Finland will need to increase its tax revenues.

¹⁰⁸ CESifo 2007.

¹⁰⁹ Jukka Lassila and Tarmo Valkonen, “Population Ageing and Fiscal Sustainability of Finland: A Stochastic Analysis,” *Bank of Finland: Discussion Papers*, (2008): 26. <http://www.bof.fi/NR/rdonlyres/ECEB5253-39F1-4E16-9AA6-4DFC4199F000/o/o828netti.pdf>.

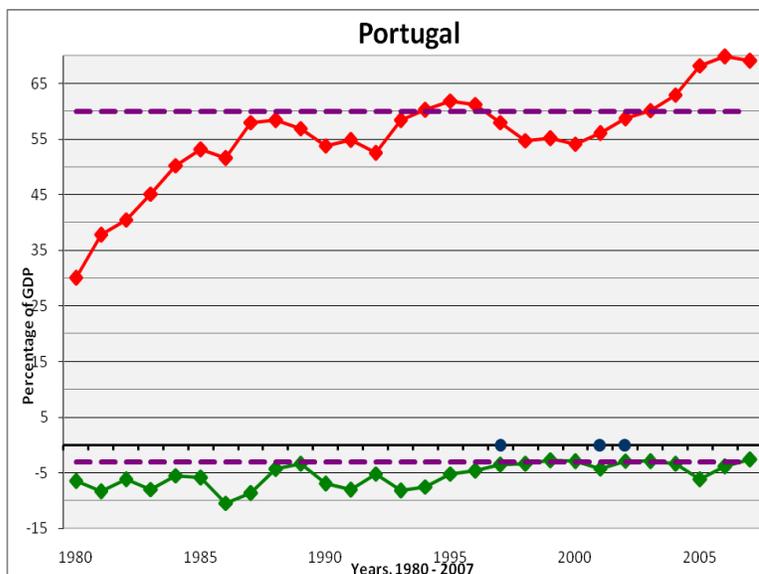
¹¹⁰ Ibid.

¹¹¹ Ibid.

Portugal

Outcome: Not Close

Portugal has consistently run deficits since 1980, but they have slowly trended closer to the 3 percent deficit to GDP ratio in recent years. This may have something to do with Portugal's increase in government revenues as a percent of GDP annually in recent years. Still, because Portugal hasn't sustained a deficit at or above 3 percent of GDP for more than two years and has failed to consistently remain below the debt limit, it doesn't meet the criteria for fiscal success.



Existence of Fiscal Rules

Like other EU countries, Portugal must comply with the targets established by the Stability and Growth Pact, though it appears they have struggled to achieve them. Besides this, Portugal has recently passed two laws dealing with fiscal balance: the 2001 Budget Framework Law and the 2002 Budgetary Stability Law, but these largely deal with budgetary processes and procedures and have less to do with targets. Still, these two laws may ultimately be important steps towards achieving a balanced fiscal budget.

Potential Factors Influencing Fiscal Stability

Portugal's efforts at reducing the fiscal deficit have largely been the result of political action seeking expenditure reductions and to a lesser extent, increasing the tax revenues.¹¹² Additionally, Portugal has been addressing reductions in the size of government: "Public Administration Reorganization has overseen a 25 percent reduction of both the central government bodies and of managerial positions."¹¹³ On a political level, Portugal has more recently devoted itself to fiscal sustainability with close to balanced budgets, increasing transparency of government procedure and regulation, enhancing incentives for human capital development, and improving confidence domestically and abroad.¹¹⁴ While Portugal's deficits appear to reflect this, they have yet to address their high level of debt.

¹¹² Fernando Teixeira dos Santos, "Structural Reforms in Portugal Recovering Public Finances and Competitiveness," *Ministry of Finance and of Public Administration*, (2008), http://www.min-financas.pt/discursos/StructuralReformsinPortugal_1.pdf.

¹¹³ *Ibid.*, 6.

¹¹⁴ *Ibid.*

B. Post-Communist European Union Member Countries

There are numerous countries within the European Union which have undergone a transition from communism in the early 1990s. In our sample, we look at three of these countries: Poland, the Czech Republic, and Hungary. All three of these countries have made vast improvements after the end of communism, to such an extent that they were accepted into the EU.

With membership to the EU, countries become subject to the Maastricht Treaty which sets fiscal ceilings for government net borrowing (3 percent of GDP) and total government debt (60 percent of GDP), with a deficit target of “close to balance or surplus.”¹¹⁵ This fiscal rule was extended in 1997 under the Stability and Growth Pact.¹¹⁶ The enforcement of deficit targeting is more stringent for prospective or newly joined countries, since becoming a member of the EU requires numerous reforms and standards. Poland, Czech Republic, and Hungary all went under substantial reform before membership was granted.

Because data was unreliable or did not exist under communism, our data and analysis on these countries do not begin until 1990. Despite a shortened time-period for analysis, there is still much to learn from their remarkable progress after communism.

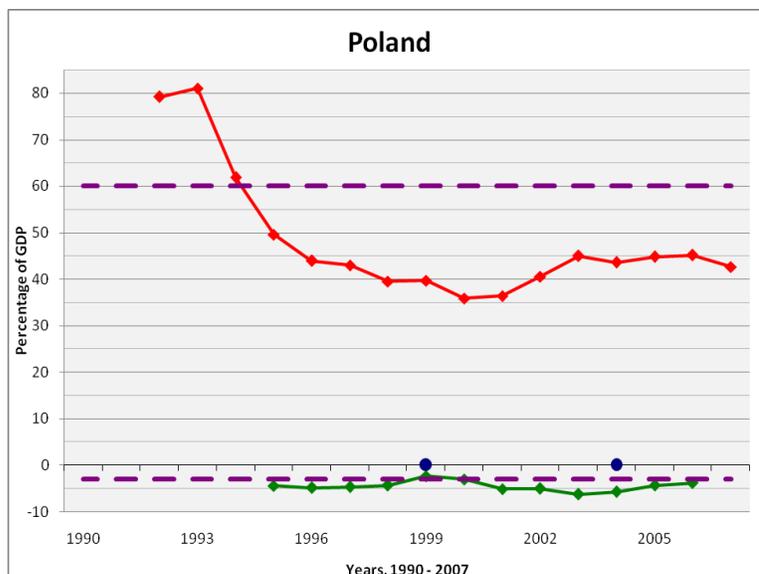
¹¹⁵ OECD 2002, Appendix Table IV.A.1.

¹¹⁶ *Ibid.*

Poland

Outcome: Not Quite

Poland has consistently run deficits, sometimes as large as 6 percent of GDP. On the other hand, debt levels have dropped below 60 percent of GDP and remained stable since 1995. Further stabilization and experience in a post-communist world could push Poland into fiscal stability.



Existence of Fiscal Rules

When Poland joined the European Union in 2004, it became subject to the Maastricht Treaty and the Stability and Growth Pact. The country has also enacted legislation of its own. The Act on Public Finance passed in 1999 constrains total public debt to 60 percent of GDP.¹¹⁷

Potential Factors Influencing Fiscal Stability

Poland experienced “uninterrupted annual economic growth averaging 5 percent during the 1990s.”¹¹⁸ The Minister of Finance has taken on numerous financial reforms. There is still much to be done to strengthen and further define the accounting, auditing, and overall financial system in Poland.¹¹⁹

Transparency has been improved in numerous aspects. For example, Poland has consolidated many extra-budgetary entities and state offices, which simplifies the budgeting process and the structure of government hierarchy. They have also made reforms which have simplified the tax system. Such reforms improve transparency because they reduce confusion and opaqueness within the structure and processes of government. Other improvements include increased internet-access of data and the pressure from the EU to comply with international standards of policy, auditing, and accounting.¹²⁰ Yet, Poland still has fiscal problems, particularly with excessive earmarking of funds and government funding for state-owned enterprises. Such policies can be rigid and inflexible, hindering the success of reform.¹²¹

¹¹⁷ OECD 2002: Appendix Table IV.A.1.

¹¹⁸ “Republic of Poland: Accounting and Auditing,” *The World Bank Report on the Observance of Standards and Codes (ROSC)*, (February 8, 2005), http://www.worldbank.org/ifa/rosc_aa_pol_eng.pdf.

¹¹⁹ *Ibid.*

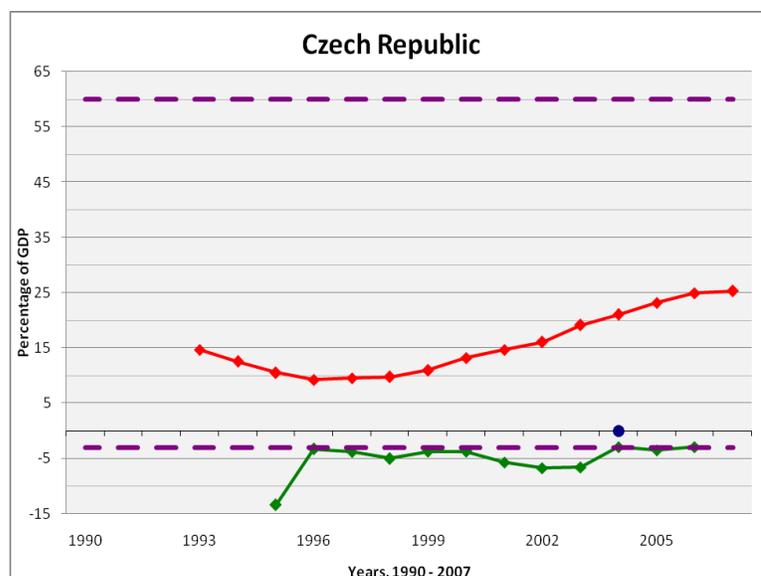
¹²⁰ “Republic of Poland: Report on Observance of Standards and Codes—Fiscal Transparency,” *IMF Country Report*, No. 04/219 (July 2004), <http://www.imf.org/external/pubs/ft/scr/2004/cr04219.pdf>.

¹²¹ *Ibid.*

Czech Republic

Outcome: Not Quite

The Czech Republic has made major improvements in stabilizing its general government balance (deficits are now around 3 percent of GDP). Additionally, their debt levels have remained low (around 10–25 percent of GDP). The Czech Republic does not meet our criteria but should be observed for future fiscal stability success.



Existence of Fiscal Rules

The Maastricht Treaty and its fiscal targeting has been a part of the Czech Republic's governance since it became a member of the European Union in 2004. No other fiscal stability legislation has been passed.

Potential Factors Influencing Fiscal Stability

Since their initial transition out of communism, the Czech Republic has made substantial steps to enhance transparency and provide reliable budget information.¹²² Even though there have been many improvements, there are still “long time lags on availability of data and there are difficulties in viewing and analyzing data.”¹²³

The public and private sectors are both switching from national to international accounting standards.¹²⁴ The central government uses “accrual accounting for fixed assets and stocks but not for tax revenues” but lacks accrual budgeting.¹²⁵ Also, local governments have gained more expenditure responsibility in the recent years, with the central government no longer liable for local debt.¹²⁶

¹²² OECD Reform 2002, 102.

¹²³ “Czech Republic: Report on Observance of Standards and Codes—Fiscal Transparency,” *IMF Country Report*, No. 04/264 (August 2004): 3. <http://www.imf.org/external/pubs/ft/scr/2004/cro4264.pdf>. [hereafter: Czech 2004]; International Accounting Standards are set by the International Accounting Standards Board, see: <http://www.iasb.org/The+organisation/IASCF+and+IASB.htm>.

¹²⁴ “Czech Republic: Accounting and Auditing,” Report on the Observance of Standards and Codes (ROSC), *The World Bank*, (July 17, 2003), http://www.worldbank.org/ifa/czerosc_aa.pdf.

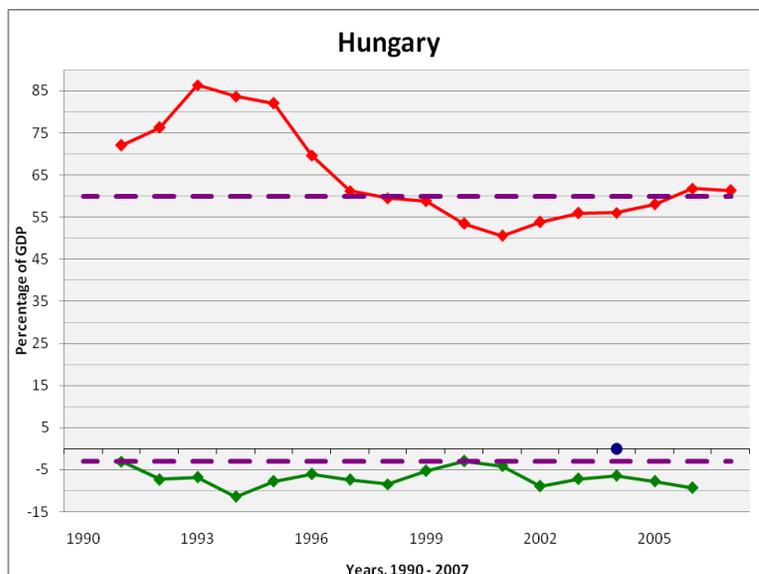
¹²⁵ CESifo 2007, 1.

¹²⁶ Czech 2004, 5.

Hungary

Outcome: Not Close

Despite EU membership and post-communist transitioning, Hungary has had volatile swings in deficit spending, ranging from 3 to 12 percent of GDP. While Hungary's debt has decreased over the time period, it still lingers around 60 percent of GDP. Through the time period available, this country has failed our fiscal stability criteria.



Existence of Fiscal Rules

Hungary has been a member of the EU since 2004 and thus subject to the Maastricht Treaty and the Growth and Stability Pact. No other fiscal stability legislation has been passed.

Potential Factors Influencing Fiscal Stability

Hungary has made substantial improvements in transparency, accuracy of data, and structural reform. In fact, it was “the first of the Central and Eastern European countries to set up a modern, fully computerized Treasury system.”¹²⁷ Hungary has also undergone reform of its auditing and accounting systems. Still, auditing lacks proper independence but does have adequate ethical codes, education standards, and training.¹²⁸ There have also been steps towards aligning with international accounting standards although all levels of government still use cash accounting.¹²⁹

¹²⁷ OECD Reform 2002, 14.

¹²⁸ “Hungary: Accounting and Auditing,” Report on the Observance of Standards and Codes (ROSC), *The World Bank*, (June 20, 2004): 3, 15. http://www.worldbank.org/ifa/roscc_aa_hun.pdf.

¹²⁹ CESifo 2007.

C. Non-European Union Member Countries

The rest of the countries within our analysis are not members of the European Union. Many of these countries have passed fiscal stability legislation of their own, while others have implemented different reforms or none at all.

United States

Outcome: Not Quite

In the past 27 years, the United States has had difficulty balancing its budget. Since the 2001 recession, the United States has been unable to achieve its once briefly successful period of fiscal balance. Yet, the United States is below the debt limit.

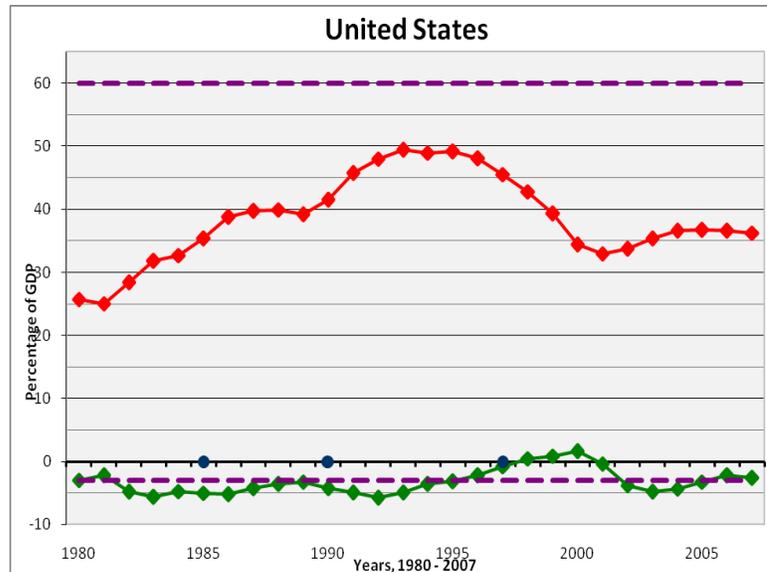
Existence of Fiscal Rules

There have been many attempts to correct its fiscal balance, but the

United States has passed only two major fiscal rules to combat excessive deficit spending. In 1985, the Balanced Budget and Emergency Deficit Control Act (or the Gramm-Rudman-Hollings [GRH] Act) was passed in order to control the federal deficit by legislative means which required massive deficit reduction each year from 1986 through 1990. The goal was to achieve a balanced budget by 1991. If the projected deficit exceeded the target for a fiscal year, then budget sequestration would occur to enforce deficit reduction.¹³⁰ The Budget Enforcement Acts of 1990 and 1997 have similar goals as their predecessor, only this time attacking temporary overspending. The BEA established two measures in order to shrink the deficit: caps on discretionary spending and pay-as-you-go (PAYGO), which was required for mandatory spending and revenue legislation.¹³¹

Potential Factors Influencing Fiscal Stability

Politically, the attempt to balance the budget has been difficult given the existence of other, sometimes contradictory, fiscal legislation. The OECD has highlighted several problems which have appeared to play a large role in the U.S. fiscal problem.¹³² First, the government chose to provide politically popular benefits at the expense of making itself fiscally worse off. Second, the government declared fixed deficit reduction goals without considering factors such as the well-being of the economy and public perception. Finally, the system's checks and balances have additionally made balancing the budget difficult with conflicting political interests.¹³³ For example, Congress has no limit to the extent they can amend the president's proposals. Essentially, changing the nature of budget processes did not produce the expected outcomes.¹³⁴



¹³⁰ OECD 2004, 448-49.

¹³¹ Ibid.

¹³² Ibid.

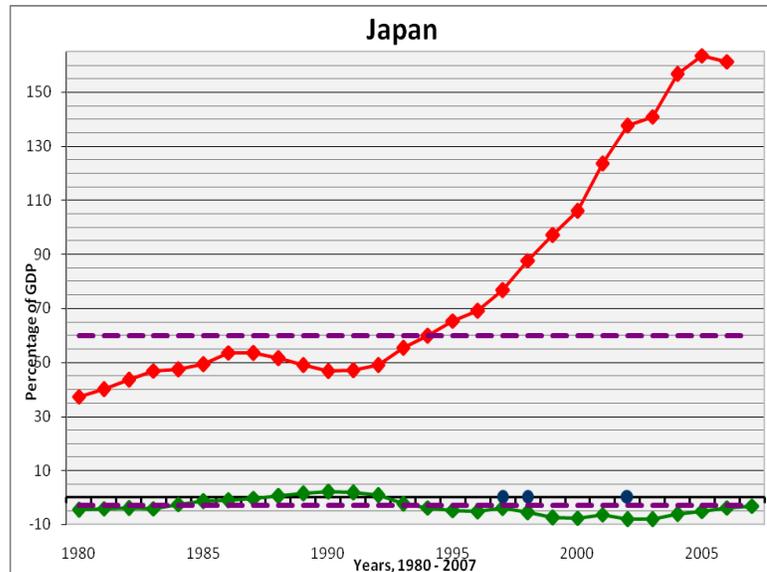
¹³³ Ibid.

¹³⁴ Ibid.

Japan

Outcome: Not Quite

For nine years, 1984–1993, Japan achieved a deficit to GDP ratio of less than 3 percent. During that time, Japan almost achieved the criteria for success, but post-1993, it has not done well with fiscal stability. As recently as 2007 however, Japan has come close to achieving fiscal balance again with a deficit to GDP ratio of 3.2 percent.



Existence of Fiscal Rules

In 1997, Japan enacted the Fiscal Structural Reform Act which: (1) restored the “golden rule,” which limited the net bonds issued to the level of domestic public investment; (2) called for shrinking the general government deficit to below 3 percent; (3) aimed to ensure the net sum of taxes, social security contributions and the fiscal deficit does not exceed 50 percent of GDP; and (4) imposed ceilings on expenditures such as social security transfers, spending on public works and education spending.¹³⁵ In response to an economic slowdown, an escape clause was added.¹³⁶ Shortly thereafter, Japan passed a Cabinet decision, the Medium-Term Fiscal Perspective, in order to maintain the size of government as measured by total government outlays to GDP ratio and achieve a fiscal balance of zero by the 2010s.¹³⁷

Potential Factors Influencing Fiscal Stability

While achieving fiscal stability has been difficult for Japan over the years, transparency and accountability for government policies have improved dramatically in the past decade. Japan practices accrual accounting, but not accrual budgeting. In May 1999, the Diet enacted a law addressing access to information held by administrative organizations. As a result, individuals may now request ministries and agencies to divulge information concerning public finance management.¹³⁸ Increasing public awareness of public finance may help political leaders achieve their targets, but it is too soon to tell whether Japan may achieve its goals. Japan’s enormous debt makes it clear much must be done to achieve “Success!”

¹³⁵ OECD 2004, 256.

¹³⁶ OECD 2002.

¹³⁷ Ibid.

¹³⁸ OECD 2004, 259.

Canada

Outcome: Success!

Since 1996, Canada has succeeded in achieving a near-zero fiscal balance. Canada has also consistently remained below the debt limit.¹³⁹

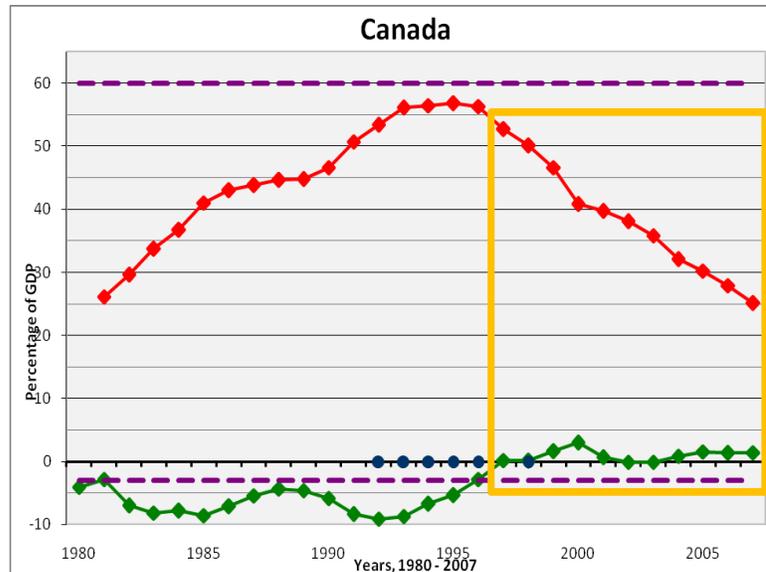
Existence of Fiscal Rules

In 1992, Canada enacted the Fiscal Spending Control Act which established expenditure ceilings on program spending over five fiscal years (through FY 1996). Over the

course of that time, only \$315 million (Canadian dollars) in spending were exempt from the ceiling. The act also allowed for overspending in any fiscal year so long as that spending was accounted for with increased government revenues equal or greater than the proposed spending within the two years following that fiscal year. Following up on its achievements since 1996, Canada also passed a law to repay debt, the 1998 Debt Repayment Plan, which entails targets for continued balanced budgets and the inclusion in the fiscal plan of a Contingency Reserve of \$3 billion in each year which may be used to pay down public debt when it is not needed otherwise.¹⁴⁰

Potential Factors Influencing Fiscal Stability

Canada had all the indicators it needed for overhauling its fiscal behavior in the early 1990s. Due to the incredible burden of a debt nearly equal to the country's GDP, Canada had the economic environment necessary to beget significant political action and discretionary policy changes. Canada experienced some unavoidable transitional economic setbacks as a result of its fiscal overhaul, but since 1998 has balanced that out with the benefit of strong economic and labor performance.¹⁴¹ In addition, Canada established public accrual accounting in 2001, and also practices accrual budgeting.¹⁴²



¹³⁹ Measures of debt here don't appear to include all levels of government.

¹⁴⁰ Don Drummond, "Budget 1998: Building Canada for the 21st Century" *The Review of Economic Performance and Social Progress*, (2001), <http://dsp-psd.pwgsc.gc.ca/Collection-R/Finance/Budget98/manpae.pdf>.

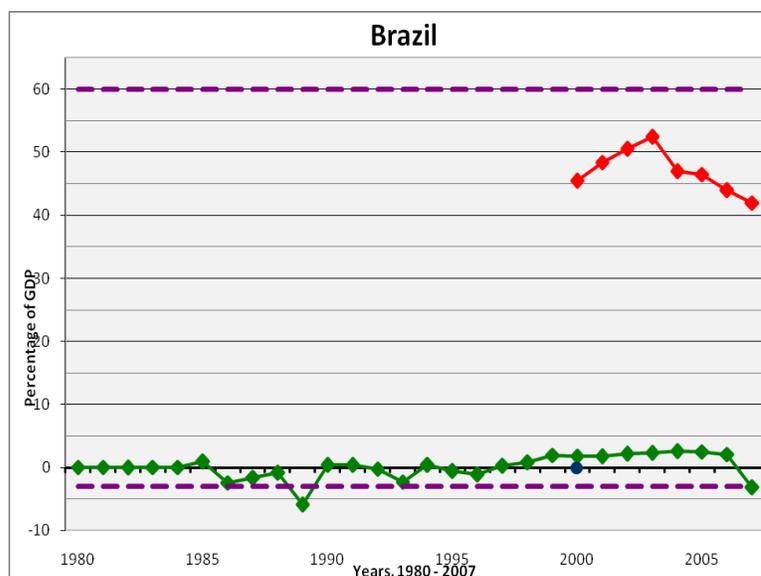
¹⁴¹ Ibid.

¹⁴² CESifo 2007.

Brazil

Outcome: Not Quite

Brazil's fiscal balance has been pristine with the exception of two minor blips: In 1989 the deficit to GDP ratio rose to 5.9 percent. In 2007 it rose again to 3.2 percent. It's too soon to tell whether this trend will continue. Brazil still falls short of attaining success because the data for debt level to GDP is missing for a majority of the time period making it impossible to determine their overall fiscal position.



Existence of Fiscal Rules

In 2000, Brazil passed the Fiscal Responsibility Law (LRF) which set a general framework for budgetary planning and a debt ceiling. There is also a “golden rule” provision, stating net borrowing cannot exceed the volume of capital spending.¹⁴³

Potential Factors Influencing Fiscal Stability

The achievement of fiscal stability in Brazil has largely been politically driven. Prior to 1998, political authorities did not display the same fiscal discipline as they have since then. The occurrence of a fiscal crisis resulting from formerly high deficits prompted action on the part of the administration to tighten fiscal policy in order to carry out fiscal adjustments. According to IMF, two factors were critical to Brazil's fiscal reformation: “First [...] there was simply a greater concern with the need to finance public expenditure adequately, since, strictly speaking, the public sector spending-to-GDP ratio had never been reduced, even during the most intense adjustment phase of 1999–2000 [...] Second, the adjustment was partly based on temporary revenues [...] due to the increase in fuel prices.”¹⁴⁴ Still, there was a significant fiscal effort carried out in 1999–2002, including the LRF. Otherwise, it appears that temporary revenues have distorted the appearance that Brazil was ever struggling. In short, it took a fiscal crisis to get Brazil back on track with fiscal stability.

¹⁴³ Luiz de Mello, “Fiscal Responsibility Legislation and Fiscal Adjustment: The Case of Brazilian Local Governments,” *World Bank Policy Research Working Paper*, no. 3812 (2006), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=875664.

¹⁴⁴ Fabio Giambiagi and Marcio Ronci, “Fiscal Policy and Debt Sustainability: Cardoso's Brazil, 1995–2002,” *IMF Working Paper*, (August 2004): 35. <http://imf.org/external/pubs/ft/wp/2004/wp04156.pdf>.

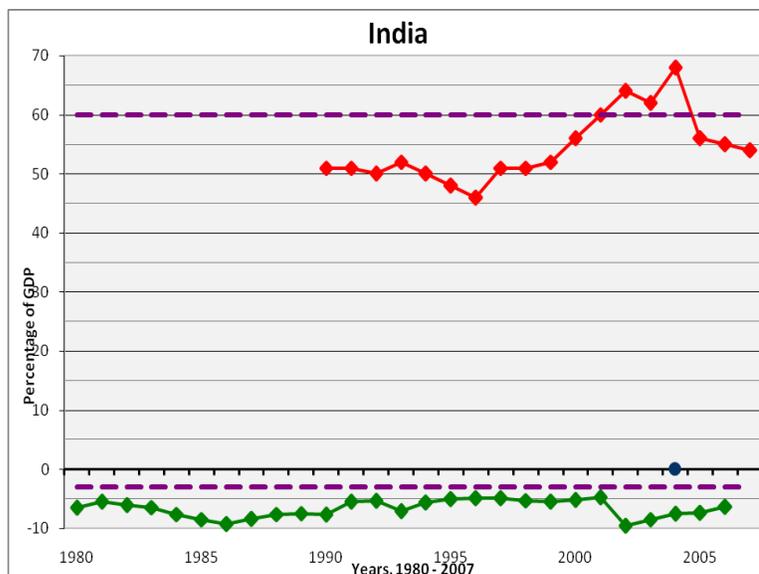
India

Outcome: Not Quite

India has struggled with coming close to achieving a 3 percent deficit to GDP ratio. This has largely resulted from the government not collecting enough revenue to support its spending nor reducing its spending.

Because of this, India has a ways to go before it achieves successful fiscal balance, but recent legislation has made the target of 3 percent a possibility. Additionally,

debt to GDP ratio data is missing for some of the time period, and when available, India has been inconsistent in meeting criteria for the debt limit.



Existence of Fiscal Rules

India enacted the Fiscal Responsibility and Budget Management Rules in 2004, setting a target of 3 percent deficit to GDP ratio by March 2008 and a zero percent target for government fiscal deficits by March 2009. This rule mandates the elimination of underfunded government revenue to make targets possible.¹⁴⁵ To achieve this, India would have to decrease government spending, or increase tax revenues.

Potential Factors Influencing Fiscal Stability

India's economy has been growing rapidly since the 1990s despite the large and growing fiscal imbalances and debt levels it's been incurring. It appears that India has found a way to reconcile sustained expansionary fiscal policies with relative macroeconomic stability, but this may be a mixed blessing.¹⁴⁶ India has relatively low final government consumption expenditures but, in spite of this, still has a negative fiscal balance.¹⁴⁷ In order to enhance government revenue, reforms focus on readjusting tax rates, better tax compliance, improving efficiency in tax administration and review of tax incentives.¹⁴⁸ Thus far, there appears to be little social or economic motivation to drive further fiscal changes.

¹⁴⁵ Sunil Kumar Sinha and Devendra Kumar Pant, "Fiscal Imbalance and the Indian Economy: Implications for Growth," Asian Development Bank, <http://www.adb.org/Documents/Reports/Consultant/TAR-IND-4066/Macroeconomic/sinha-pant.pdf>.

¹⁴⁶ Peter S. Heller and M. Govinda Rao, eds., "A Sustainable Fiscal Policy For India - An International Perspective," *Reserve Bank of India Occasional Papers*, Vol. 28, No. 1, (Summer 2007), (New Delhi: Oxford University Press, 2006), <http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/82936.pdf>.

¹⁴⁷ For a definition of final government consumption expenditure, see footnote 93.

¹⁴⁸ Heller and Rao, 2007.

Republic of Korea (South Korea)

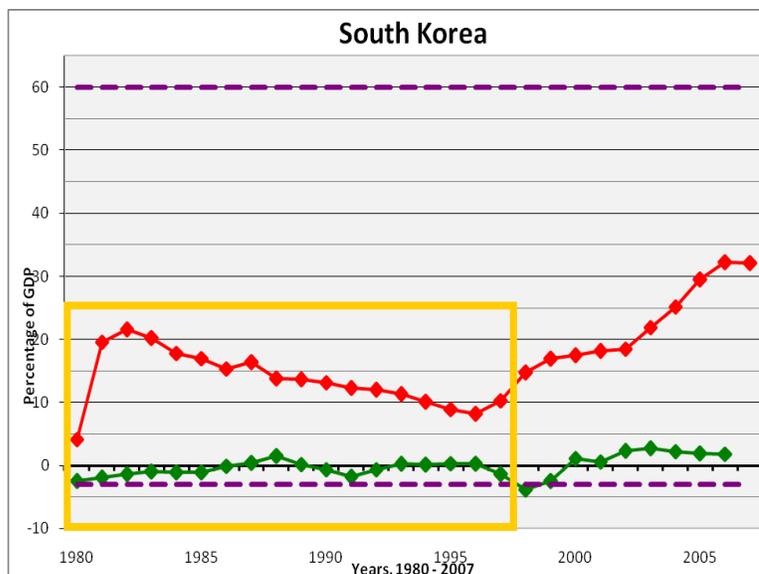
Outcome: Success!

With the exception of one dip below the 3 percent deficit to GDP ratio, South Korea has achieved sustained fiscal balance at least since 1980 and has consistently remained below the debt limit.

Existence of Fiscal Rules

The early 1980s marked a period of stabilization and recovery from the fiscal crisis of 1979–1980.¹⁴⁹

There's no current major policy that governs South Korea's commitment to sustained fiscal balance.



Potential Factors Influencing Fiscal Stability

Unlike many other countries where fiscal downturns required cuts in social expenditures after financial crises, the crisis of 1997–98 allowed South Korea to increase social spending without much of a blow to their general government balance.¹⁵⁰ Like other Asian economies, South Korea felt the effects of Japan's collapse during that time. Still, this resilience emphasizes the difference between South Korea and other countries by revealing South Korea's relatively conservative fiscal policy and low priority for social policies in the first place.¹⁵¹ South Korea also meets international standards in transparency, accountability, and has a modern budget process for a central government.¹⁵² After transitioning from authoritarian to democratic rule in 1987, "the central government expenditure on social services in Korea gradually increased from 5.0 percent of GDP in 1980 to 7.8 percent in 1997."¹⁵³ For the future, low contribution rates relative to the expected benefit rates to the National Pension plan will generate a fiscal imbalance, expected to create a deficit by 2023 if nothing is done about it.¹⁵⁴

¹⁴⁹ Jong-Il You and Ju-Ho Lee, "Economic and Social Consequences of Globalization: The Case of South Korea," Korea Development Institute, Center for Economic Policy Analysis, (February: 2000), <http://www.newschool.edu/cepa/papers/archive/cepa0117.pdf>. [hereafter: South Korea 2000]

¹⁵⁰ South Korea 2000.

¹⁵¹ Ibid.

¹⁵² OECD 2004, 284-85.

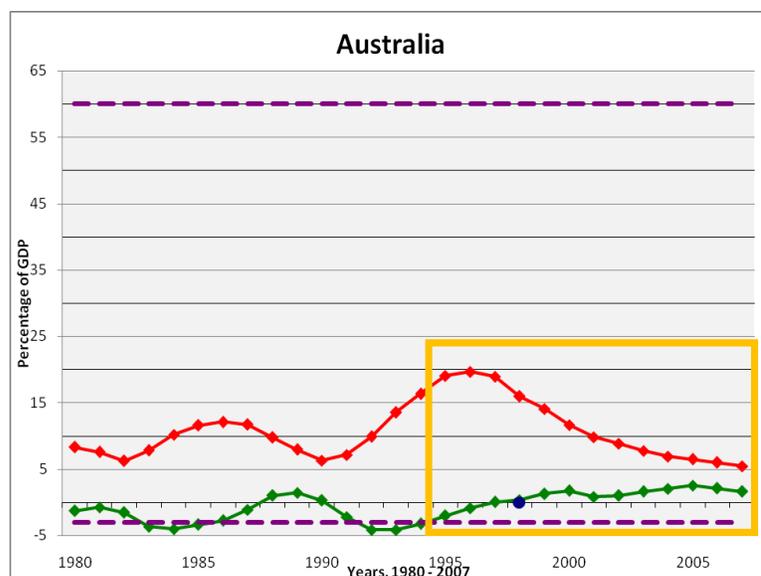
¹⁵³ Ibid, 19.

¹⁵⁴ Ibid.

Australia

Outcome: Success!

Australia has been in a period of fiscal stability success since 1995. The country has been enjoying small general government surpluses (below 3 percent of GDP) since 1997. Additionally, Australia's debt is low relative to other countries, having peaked at 20 percent of GDP during the time period.



Existence of Fiscal Rules

The Charter of Budget Honesty of 1998 is the major fiscal stability legislation in Australia. “The Charter requires the government to spell out objectives and targets but places no constraints on their nature.”¹⁵⁵

Potential Factors Influencing Fiscal Stability

According to a report by Australia's Treasury, there are two significant factors which motivated fiscal stability reform. The first factor was substantial current account deficits and subsequently increasing net foreign liabilities. The second factor was a “desire to provide fiscal policy flexibility to respond to the ageing of the population and the projected rising public cost of health services.”¹⁵⁶ While the large current account deficit was the major concern behind reform, it is no longer a cause for alarm.¹⁵⁷

Australia has introduced numerous reforms, including: tariff reductions in numerous sectors (mid 1980s and 1990s), an inflation target (1993) modeled after New Zealand's monetary rule, labor market training and productivity reform (late 1980s and late 1990s), and more.¹⁵⁸

Australia's government introduced accrual accounting and budgeting reforms in 1997, which have since been fully implemented.¹⁵⁹

¹⁵⁵ OECD 2002, Appendix Table IV.A.1.

¹⁵⁶ David Gruen and Amanda Sayegh, “2005-04: The evolution of fiscal policy in Australia”, *Treasury Working Paper*, (November 2005): 1. http://www.treasury.gov.au/documents/1033/HTML/docshell.asp?URL=TW_2005-04.htm.

¹⁵⁷ Ibid, 10-12. [Academic research states “that private-sector investment and saving decisions were made by consenting adults who would reap the benefits or incur the costs of those decisions” and Australia has incurred large economic growth despite continued large current account deficits throughout the 1990s and 2000s.]

¹⁵⁸ Graeme Davis and Robert Ewing, “Why has Australia Done Better than New Zealand? Good Luck or Good Management?” *Treasury Working Paper*, (January 2005): 3-4.

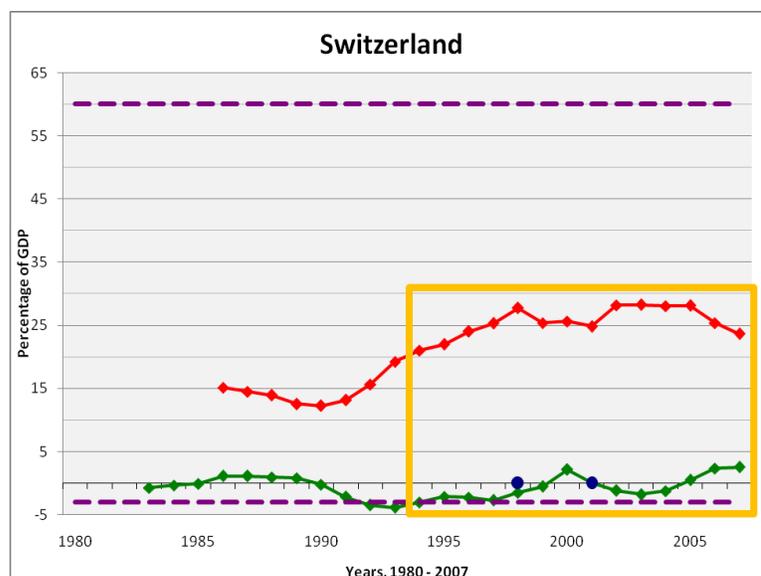
<http://www.treasury.gov.au/documents/949/HTML/docshell.asp?URL=Treasury%20Working%20Paper%202005-01.htm>.

¹⁵⁹ CESifo 2007.

Switzerland

Outcome: Success!

Switzerland is a success under our criteria. In fact, the debt level is consistently below 30 percent of GDP. The country's general government balance has been rather volatile during this period, reaching peaks of surpluses just over 2 percent of GDP and then dipping into deficits around 2 percent of GDP. Despite these fluctuations, Switzerland has been in surplus since 2005.



Existence of Fiscal Rules

Switzerland has two distinct fiscal rules, the Budget Objective of 1998 and the Debt Containment Rule of 2001. The Budget Objective aimed at capping the federal deficit at 0.25 percent of GDP by 2001 and established that excess expenditures should be financed through increased taxes. Additionally, the Debt Containment Rule established a structure to make expenditures equal to total revenues. An escape clause exists for exceptional circumstances where the rule can be suspended with an absolute majority approval from the parliament.¹⁶⁰

Potential Factors Influencing Fiscal Stability

The Swiss government is decentralizing their management structure and putting an emphasis on outputs and outcomes. Additionally, their federalist structure puts financial responsibility at a regional level with local governments standardizing accounting and data compilation on their own accord.¹⁶¹ Swiss “government agencies have always been closer to the private sector in character than neighboring countries. This is due to non-professionals in parliament and part-time civil servants in the local governments.”¹⁶² The government encourages experimental reform and operates in full accrual accounting and budgeting.¹⁶³

¹⁶⁰ OECD 2002: Appendix Table IV.A.1.

¹⁶¹ OECD Reform 2002, 243.

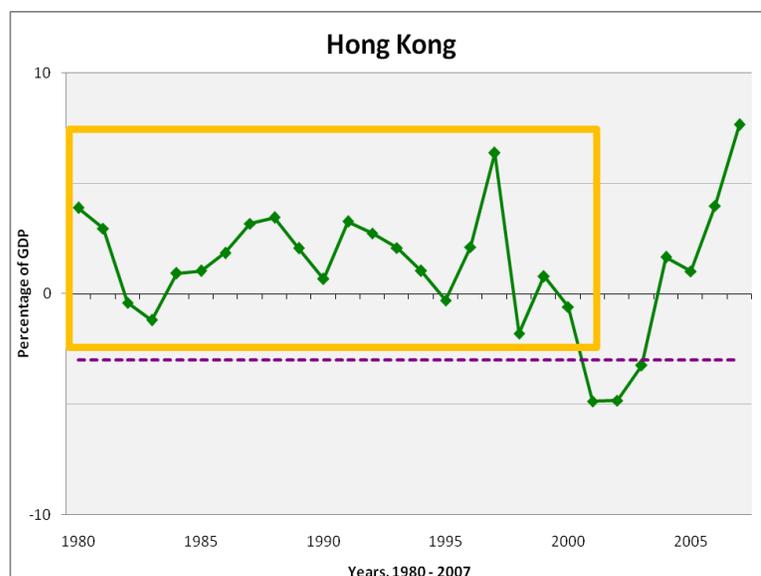
¹⁶² Ibid, 244.

¹⁶³ “OECD Budget Practices & Procedures Survey: Accounting basis applied for budget approved legislature,” *OECD Journal on Budgeting*, Vol. 3, No. 1, 2003.

Hong Kong (China)

Outcome: Success!

Hong Kong has no debt and a long track record of small deficits and surpluses. The country is deemed a success under our criteria from 1980–2000, a full 20 years of fiscal stability (this may be longer due to our time constraint on data). In 2001, Hong Kong’s general government balance dipped below the 3 percent of GDP threshold and stayed there for three years until jumping back up to surpluses.



Existence of Fiscal Rules

Hong Kong has no fiscal stability legislation as of date.

Potential Factors Influencing Fiscal Stability

The IMF states that Hong Kong’s finances are independent of Mainland China and its government activities are limited, under good management, and transparent.¹⁶⁴ The country also has no government debt and emphasizes strict compliance with financial regulations, output-oriented budgeting, and auditing. “Hong Kong’s fiscal reserves can be used for operational requirements of government, to offset effects of cyclical downturns and unforeseen external shocks, [and] to underpin exchange rate stability.”¹⁶⁵

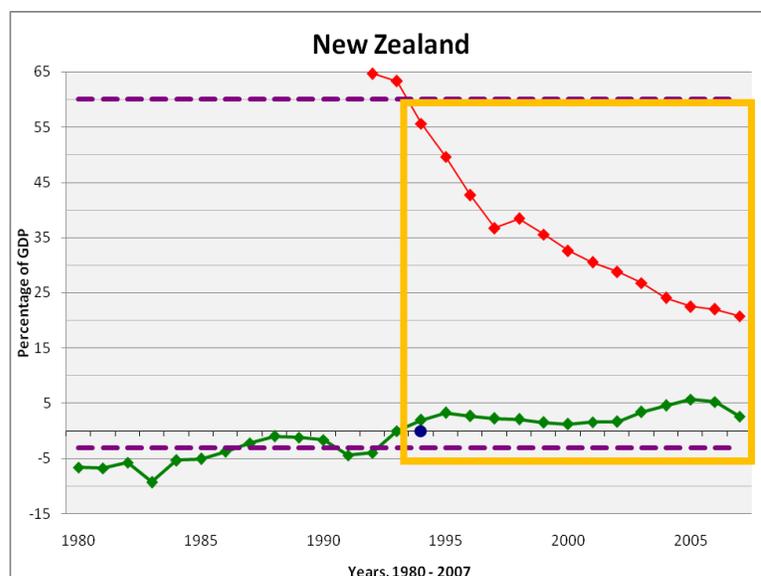
¹⁶⁴ “Hong Kong Special Administrative Region, People’s Republic of China: Report on Observance of Standards and Codes—Fiscal Transparency,” *Experimental IMF Report on Observance of Standards and Codes*, (August 30, 1999): 1. <http://www.imf.org/external/np/rosc/hkg/index.htm>.

¹⁶⁵ *Ibid.*

New Zealand

Outcome: Success!

New Zealand has had a long run of general government balance surpluses since 1993. By using these surpluses to pay off debt, debt levels have been under 60 percent of GDP since 1994 and continue to shrink. For these reasons, New Zealand has achieved success under our criteria.



Existence of Fiscal Rules

The Fiscal Responsibility Act of 1994 is the major fiscal rule in New Zealand. This legislation requires “prudent” levels of debt and net worth with surpluses over a “reasonable amount of time.”¹⁶⁶ By running surpluses, the government was able to substantially reduce its total debt. In order to ensure flexibility, current governments set fiscal targets.

Potential Factors Influencing Fiscal Stability

New Zealand’s state sector reforms are noteworthy because of their “speed, comprehensiveness, and explicit theoretical framework.” Accounting and budgeting have been at the forefront of these reforms, with “appropriations, budgeting, output costing and external reporting, including whole-of-government financial statements, on a full accruals basis.”¹⁶⁷

After the accumulation of massive government debt and large deficits in the 1980s, leaders were influenced by institutional economic theory which encouraged their reform agenda. Through the ambition of reform-driven politicians, changes brought managerial and market-based organization and improvements to the public sector. In summary, OECD states that “New Zealand’s small size, island shape,¹⁶⁸ and unitary government structure,” as well as a managerial, not bureaucratic, government focus and a do-it-yourself social attitude, “all make it better suited to innovation and change.”¹⁶⁹

¹⁶⁶ OECD 2002: Appendix Table IV.A.1.

¹⁶⁷ OECD Reform 2002, 163.

¹⁶⁸ Island shape is interpreted to mean isolation from other governments and the subsequent political pressure of other communities and countries. This characteristic may become less important as global networking and information exchange increases in occurrence and speed.

¹⁶⁹ OECD Reform 2002, 177.

V. Conclusion

The following section provides a summary of the individual country analyses, compares the results of these analyses to the existing literature, and hypothesizes on the implications and further use of the results. Our intention is to find reforms, actions, and events which correlate with the ability to achieve fiscal stability.

A. Summary of Individual Country Analyses

Every country's actions and experiences are different, reflecting their unique cultural, sociological, and economic characteristics. Yet, through exchange at the regional and global levels, economies are often affected by the actions, reforms, and circumstances of one another. While reading through our individual analyses, one should be able to pinpoint periods where numerous countries were affected by external circumstances. In fact, fiscal deterioration may, from time to time, be due to external factors that are outside of the economy's control. Specifically, Japan's economic collapse indirectly affected the other Asian economies, the German unification reforms and consequences spread to Austria, and the creation and the assimilation of the European Union has both beneficial and costly consequences to the economies involved.

Many countries within our study share some common characteristics, including the existence of some form of fiscal stability legislation, a parliamentary government, and a movement towards more open and transparent governments. In fact, most countries in the world have parliamentary governments and all OECD member countries are encouraged to improve transparency. The countries in our analysis, by the restrictions of our selection methods, are democratic nations with high GDPs and have a history of consistently reporting data of sound integrity. For these reasons, our selection will most likely contain a larger percentage of countries who are fiscally prudent than the world as a whole.

Still, some general correlations can be drawn from our analysis. The countries within our analysis with the most common characteristics are members of the European Union. The EU countries within our selection are all subject to the budget targets of the Maastricht Treaty and the Growth and Stability Pact, all have a parliamentary government structure, and all are moving toward more open and transparent governments. Three out of sixteen EU members (the Netherlands, Ireland, and Finland) have achieved fiscal stability success under our criteria. Two out of three EU countries with an outcome of "Success!" (The Netherlands and Ireland) have another form of fiscal stability legislation, while all countries with "Not Quite" or "Not Close" have their own fiscal legislation. Successful countries practice or are implementing reforms to practice accrual accounting within the government, although many EU members are still operating on a cash accounting basis. Many countries which do not achieve "Success!" under our criteria have been making substantial reforms, especially the post-communist countries, yet further time and commitment to fiscal stability may be necessary before success can be

achieved. Also, accrual accounting and budgeting practices are found or being implemented in all three of the “Success!” countries.

Non-European Union members have a much higher likelihood of achieving fiscal stability success, with six out of ten countries achieving success (Canada, South Korea, Australia, Switzerland, Hong Kong, and New Zealand). Four of the six successful countries (Canada, Switzerland, Australia and New Zealand) have fiscal rules while all of the “Not Quite” and “Not Close” countries have fiscal rules. Additionally, five out of six successful countries (Canada, South Korea, Australia, Switzerland, and New Zealand) tend to practice or are implementing reform to practice accrual accounting and budgeting within their central government.

The following table summarizes our country analyses, including fiscal stability outcomes, legislation, and political climate (parliamentary structure, accrual accounting and budgeting, and transparency). The other factors discussed in our analysis, such as the influence of economic and social situations on fiscal reform and stability, are not included in the table due to their subjective nature.

Table 1: Summary

Group	Fiscal Stability Outcome	Country	Legislation			Political Climate			
			Budget Targeting	Expenditure Limits	General Budget Provisions	Parliament	Accrual Accounting	Accrual Budgeting	Open & Transparent Reporting
EU Countries	Successful	Netherlands	Y	Y	N	Y	M	I	Y
		Ireland	Y	N	Y	Y	A & C	A & C	Y
		Finland	Y	N	N	Y	M	A	Y
	Not Quite	UK	Y	N	Y	Y	A	A	Y
		France	Y	N	Y	Y	I	I	Y
		Spain	Y	N	Y	Y	A	A	Y
		Belgium	Y	N	Y	Y	M	M	Y
		Sweden	Y	Y	N	Y	M	I	Y
		Austria	Y	Y	Y	Y	C	M	Y
		Denmark	Y	Y	Y	Y	I	M	Y
	Not Close	Italy	Y	Y	Y	Y	A & C	A & C	Y
		Greece	Y	Y	N	Y	C	M	Y
		Portugal	Y	N	Y	Y	M	I	Y
Post-Communist EU Countries	Not Quite	Poland	Y	N	Y	Y	A	I	Y
		Czech Republic	Y	N	N	Y	C	I	Y
	Not Close	Hungary	Y	N	N	Y	C	I	Y
Non-EU Countries	Successful	Canada	N	Y	Y	Y	A	A	Y
		South Korea	N	N	N	Y	I	I	Y
		Australia	N	N	Y	Y	A	A	Y
		Switzerland	Y	Y	Y	Y	A	I	Y
		Hong Kong	N	N	N	N	I	C	Y
		New Zealand	N	N	Y	Y	A	A	Y
	Not Quite	US	N	Y	Y	N	M	M	Y
		Japan	Y	Y	Y	Y	A	C	Y
		Brazil	N	Y	Y	N	C	C	Y
		India	Y	N	N	Y	C	C	Y

Note: Countries with an outcome of "Not Quite" are broken down by their successful feature. Debt is light green; deficit is dark green.
Sources: OECD 2002, ADB 2005, & OECD Budget Practices and Procedures Survey: Accounting basis applied for budget approved legislature, OECD Journal on Budgeting - Vol 3, No 1 - 2003
A = Full accrual basis; M = Modified accrual/mixed; I = Introducing; C = Full cash basis

In order to gain a better grasp on transparency, a comparison of our fiscal stability outcomes and a transparency standards index appears below. The Financial Standards Forum, a non-profit organization directed towards “global economic and financial system(s),” has developed an index on transparency compliance within global governments called the Standards

Compliance Index.¹⁷⁰ The Standards Compliance Index “measures a country's level of compliance with the 12 Key Standards for Sound Financial Systems, issued by international standard-setting bodies.”¹⁷¹

Specifically, we look at an index that includes compliance with data dissemination, money transparency, and fiscal transparency at the government level for the years 2003 and 2007. We recognize that the narrow timeline, due to the availability of the index, restricts our analysis; nonetheless, it will provide a look into the level of transparency achieved by each economy. Data dissemination measures a countries compliance with international guidelines when they collect and publish data, using IMF codes (1996 Special Data Dissemination Standard and 1997 General Data Dissemination System). Money transparency measures the compliance of central bank information disclosure against the IMF Code of Good Practices on Transparency in Monetary and Financial Policies, which focuses on clarity of the mission and reporting process as well as the public availability of information. Finally, fiscal transparency measures compliance to the IMF Code of Good Practices on Fiscal Transparency, which includes clarity of mission, open budget processes, public availability of information, and assurances of integrity regarding fiscal information provided by the government.¹⁷²

All but two countries (Hungary and Greece) have maintained or increased their level of compliance from 2003 to 2007. All 26 countries receive either very high or high compliance rankings in 2007. Beyond the observation of generally high compliance for all the countries in our analysis, which is a characteristic of OECD membership, there appears to be no strong correlation between fiscal stability success and an especially high level of transparency compliance from this index. Two of the “Not Close” countries decreased their level of compliance over the period and none of the “Not Close” countries receive higher than an 87 in this index during 2007. Since our analysis does not include inadequately transparent countries, we cannot determine the extent to which transparency correlates with fiscal stability success. Yet, we can note that all countries are working on transparency, including the ones successful at fiscal stability. The chart below shows these results.

¹⁷⁰ About Us, “Financial Standards Forum,” eStandardsForum, <http://www.estandardsforum.org/about/fsf.jsp>.

¹⁷¹ Research & Methodology, “Standards Compliance Index,” eStandardsForum, <http://www.estandardsforum.org/jhtml/rm/#>.

¹⁷² 12 Key Standards for Sound Financial Systems, “Macroeconomic Policy and Data Transparency,” eStandardsForum, <http://www.estandardsforum.org/jhtml/standards/>.

Table 2: Compliance Level for data dissemination, money transparency, and fiscal transparency				
Group	Rating	Country	Jan-03	Dec-07
EU Countries	Success!	Netherlands	60	93.33
		Ireland	60	93.33
		Finland	60	86.67
	Not Quite	UK	86.67	100
		France	86.67	100
		Spain	60	86.67
		Belgium	60	93.33
		Sweden	80	86.67
		Austria	60	93.33
		Denmark	26.67	86.67
	Not Close	Italy	86.67	86.67
		Greece	86.67	80
Portugal		60	80	
Post-Communist EU Countries	Not Quite	Poland	73.33	80
		Czech Republic	80	93.33
	Not Close	Hungary	86.67	80
Non-EU Countries	Success!	Canada	93.33	100
		South Korea	66.67	80
		Australia	86.67	100
		Switzerland	53.33	80
		Hong Kong	80	80
		New Zealand	70	70
	Not Quite	US	93.33	93.33
		Japan	73.33	86.67
		Brazil	80	86.67
		India	56.67	73.33

Note: Countries with an outcome of "Not Quite" are further broken down by the their successful feature. Debt is light green and deficit is dark green.
Source: <http://www.estandardsforum.org/jhtml/ca/compare/>

Level of Compliance	Score
Very High	80-100
High	60-80
Medium	40-60
Low	29-40
Very Low	0-20

In addition to the factors found in Table 1 and further explored in Table 2, there are commonalities found within the case studies and country histories examined and summarized within our analysis. Countries who achieved “Success!” seem to either (1) have a history of stability and transparency or (2) have faced some crisis which motivated fiscal stability and

other government reform. Similar to the first commonality, OECD concludes that countries that do well at fiscal stability without formally adopted fiscal rules tend to have a well-established fiscal norm for balanced budgets that is accepted by both the government and its citizens.¹⁷³

The second commonality underscores the fact that changes in the economic climate (such as economic crises, recessions, technological advances, and other factors) may precipitate public sector reform. The magnitude of any single one of these factors on fiscal stability is very difficult to measure, but they nonetheless appear to be important factors involved in a government's change towards or away from fiscal stability. For instance, those countries within our selection that had extreme public debt and sustained high fiscal deficits reached a crisis prompting them to rein in government spending and achieve fiscal stability within a short period of time. A crisis can include any or all of the following: large impending government deficits and debt, an economic recession, large current account deficits, credit downgrades, an aging population, building pressure from academia, and overall public awareness and concern. It is our observation and belief that in order for a crisis to spur fiscal stability (instead of encourage further deficit spending) both the private and public sectors must recognize the existence of the crisis and the need for action. Then the public sector must be willing to enact and enforce the reforms needed in order to put the country back into economic stability.

B. Comparison to Existing Literature

Our analysis confirms many of the conclusions and recommendations from existing literature. Specifically, many of the "Successful!" countries (such as Australia, Canada, New Zealand, and Switzerland) have flexible fiscal rules, a high compliance of transparency reporting, accrual accounting and budgeting methods, and have implemented overall government reform.

Counter to some of the literature, the rules within the Maastricht treaty appear to have disciplined European countries but not to the extent of prevalent balanced budgets. Such results lead to the question as to whether the numerical targets implemented ultimately determine the results of fiscal stability. If the Growth and Stability Pact had focused on a target of one or zero percent instead of three percent, would there have been a larger trend towards government budget balance? The impact of numerical targets on the discipline of policy makers follows the public choice literature. These rules were adhered to but most economies were not actively going beyond the standard. It could be argued that policy makers behaved in this way in order to appear responsible and maintain electoral favor. Along these lines, both EU member and non-member countries that have implemented their own rules (specifically general budget provisions) appear to be more disciplined.

¹⁷³ OECD Reform 2002.

These conclusions reaffirm our stance that countries achieving “Success!” tend to either (1) have a history of stability and transparency or (2) have faced some crisis which motivated fiscal stability and other government reform. Countries (such as Hong Kong and South Korea) have a history of fiscal prudence, enabling them to achieve “Success!” without the implementation of any fiscal stability legislation. Other countries (such as New Zealand, Australia, and Ireland) faced crises that spawned reform and discipline for fiscal stability.

C. Implications

While the movement towards balanced budgets and prudent debt levels is still fairly new, much can be learned from the progress made thus far. This research has illuminated that countries making reforms in accounting and reevaluating the roles of government (to respond to a national crisis or to earn a competitive edge) have been able to achieve and sustain fiscal stability. In the recent past, economies were not motivated to reform until faced with some form of economic crisis. In the future, governments should take these lessons to heart and implement accrual accounting and budgeting, transparency, and competitive reforms before such crises take place.