FOCUS · Fiscal adjustment in the periphery: a job half done

The periphery has made a significant fiscal consolidation effort over the last few years; nevertheless it is not easy to measure and analyse the composition of this consolidation accurately. For example, in a recession, budget balances tend to deteriorate as tax revenue drops due to the decline in economic activity while there is an increase in some items of expenditure, such as unemployment benefits. There is also extraordinary expenditure, such as financial bail-outs for banks. The opposite occurs in a recovery. In order to correctly measure the fiscal effort it is therefore important to take into account the effect of cyclical factors.

The budget balance adjusted for the effects of the economic cycle and minus interest costs is known as the underlying primary balance. If we look at the evolution trends of this balance in the peripheral countries between 2009 and 2013 we can see that the fiscal adjustment these countries carried out[1] was above 1 pp of GDP per year. In general, the adjustment which focused on reducing expenditure items was, on average, 4 pps of GDP, while the increase in income was 2 pps.

Focusing on expenditure, the largest adjustment was in public investment, which was cut by almost half in the peripheral countries as a whole and made up half the total adjustment in public spending (2 pps of GDP). Of note is the reduction in transport infrastructure, military defence and investment related to the provision of general services. There was less adjustment in the other items of expenditure but the cuts were nevertheless considerable: current expenditure on education and healthcare fell by 9% while intermediate consumption and spending on other civil servant wages was cut by 6%.

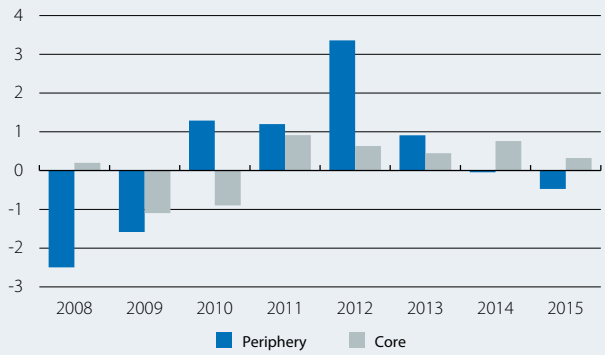
To carry out these adjustments and quickly reduce the deficit, countries mostly resorted to measures that could be rapidly implemented. Some of these measures may have negatively affected the provision of public services although in most cases it is not easy to measure their impact. For example, cuts in healthcare spending have lengthened waiting lists in the peripheral countries and seem to have affected the quality of the service provided: the proportion of citizens satisfied with the availability of good quality healthcare, in general, has decreased.[2] Nevertheless, structural measures were also implemented which should improve the efficiency and transparency of the provision of public services. In this respect, of note is the promotion of online platforms and purchasing centres in public procurement and the restructuring and simplification of public corporations and bodies.

1. An episode of fiscal consolidation is usually defined as a period of two or more consecutive years of improvements in the primary structural budget balance.
2. See «OECD, Government at a Glance 2015».

An analysis of the fiscal adjustment in Europe's peripheral countries over the last few years shows that it particularly focused on expenditure items. However, the way in which this adjustment has been carried out raises doubts as to whether it can be sustained. Firstly because most of the adjustment was focused on public investment which plays an important role in determining a country's growth potential. In fact, given the high level of government debt, high unemployment rates and poor growth prospects in several countries in the periphery, this is one of the items that should have been adjusted the least. And secondly because the quality of public services also seems to have been affected and citizens are unlikely to accept this over the medium term. In summary, for the adjustment in public spending to be structural and sustainable over the medium term, the focus should be on improving the efficiency with which public services are provided.

Euro area: change in the primary structural balance in peripheral and core countries

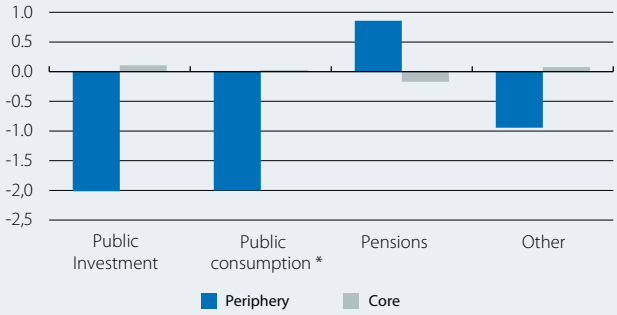
(pps of potential GDP)



Note: *The peripheral countries are Spain, Ireland, Italy, Greece and Portugal. The core countries are Germany, Austria, Belgium, Finland, France and Netherlands.*
Source: *CaixaBank Research, based on OECD data.*

Composition of the adjustment in public expenditure

(pps of potential GDP)



Notes: *The peripheral countries are Spain, Ireland, Italy, Greece and Portugal. The core countries are Germany, Austria, Belgium, Finland, France and Netherlands. Adjustment period: Germany, Finland France and Portugal (2011-2013); Austria, Belgium, Spain and Greece (2010-2013); Ireland (2009-2013); Italy (2010-2012) and Netherlands (2012-2013).*
** Public consumption includes spending on education, healthcare, other wages and intermediate consumption.*
Source: *CaixaBank Research, based on OECD data.*