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Editor’s notes

(April 19, 2012) The headings in Figure A1.4 on page 38 have been changed in the second printing to correct a typographical error.

(May 1, 2012)
The following changes have been made in the third printing:

1. Figure 6 on page 14 has been revised to add data for the United States.
2. In Statistical Tables 9a and 9b, pages 69–70, on structural fiscal indicators for advanced and emerging economies, respectively, data in the second column, “Net present value of pension spending change, 2010–50,” have been revised as follows:
   - In Statistical Table 9a, the statistic for Austria has been changed from –40.1 to 20.3; and the advanced economies average has been changed from 31.1 to 31.6.
   - In Statistical Table 9b, the statistic for Turkey has been changed from 243.3 to 150.1; the statistic for Ukraine has been changed from 346.4 to 84.6; the emerging economies average has been changed from 66.6 to 61.3; and the G-20 emerging average has been changed from 92.9 to 88.7.
3. In Statistical Table 9a, page 69, data for the Slovak Republic have been added to replace ellipsis points, as follows:
   - For “Pension spending change, 2010–30,” the statistic is 0.7.
   - For “Net present value of pension spending change, 2010–50,” the statistic is 25.5.
   - For “Health care spending change, 2010–30,” the statistic is 1.2.
   - For “Net present value of health care spending change, 2010–50,” the statistic is 37.1.
The inclusion of these data for the Slovak Republic necessitated correction of the advanced economies average in the table, as follows:
   - For “Pension spending change, 2010–30,” the average has been changed from 1.2 to 1.1.
   - For “Net present value of health care spending change, 2010–50,” the average has been changed from 100.6 to 100.3.
4. In Statistical Table 10a, page 71, data for the Slovak Republic have been added to replace ellipsis points, as follows:
   - For “Age-related spending, 2011–30,” the statistic is 1.8.
   - For “Required adjustment and age-related spending, 2011–30,” the statistic is 6.2.
The projections included in this issue of the Fiscal Monitor are based on the same database used for the April 2012 World Economic Outlook and Global Financial Stability Report (and are referred to as “IMF staff projections”). The fiscal projections refer to the general government unless otherwise indicated. Short-term fiscal projections are based on officially announced budgets, adjusted for differences between the national authorities and the IMF staff regarding macroeconomic assumptions. The medium-term fiscal projections incorporate policy measures that are judged by the IMF staff as likely to be implemented. For countries supported by an IMF arrangement, the medium-term projections are those under the arrangement. In cases in which the IMF staff has insufficient information to assess the authorities’ budget intentions and prospects for policy implementation, an unchanged cyclically adjusted primary balance is assumed, unless indicated otherwise. Country-specific assumptions are detailed in the Methodological and Statistical Appendix, which precedes the Statistical Tables.

The Fiscal Monitor is prepared by the IMF Fiscal Affairs Department under the supervision of Carlo Cottarelli, Director of the Department, and Philip Gerson, Deputy Director. This issue is coordinated by Martine Guerguil. Principal contributors include Nina Budina, Laura Jaramillo Mayor, Tigran Poghosyan, and Anke Weber. Nathalie Carcenac, Petra Dacheva, and Raquel Gomez Sirera provided outstanding research assistance. In addition, contributions were provided by Ali Abbas, Elif Arbatli, Mark De Broeck, Xavier Debrun, Julio Escolano, Luc Eyraud, Borja Gracia, Bertrand Gruss, Jiri Jonas, Carsten Jung, Stella Kaendera, Tidiane Kinda, Andrea Lemgruber, Paolo Mauro, Jimmy McHugh, Marialuz Moreno-Badia, Geremia Palomba, Iva Petrova, Marcos Poplawski-Ribeiro, Rafael Romeu, Andrea Schaechter, Abdel Senhadji, Anna Shabunina, Mauricio Soto, and Mauricio Villafuerte. Maria Delariarte and Nadia Malikyar provided excellent administrative and editorial assistance. From the IMF External Relations Department, Nancy Morrison and Michael Harrup edited the volume, and Michael Harrup managed its production.

Inputs, comments, and suggestions were received from other departments in the IMF, including area departments—namely, the African Department, Asia and Pacific Department, European Department, Middle East and Central Asia Department, and Western Hemisphere Department—as well as the IMF Institute, Monetary and Capital Markets Department, Research Department, Statistics Department, and Strategy, Policy and Review Department. Both projections and policy considerations are those of the IMF staff and should not be attributed to Executive Directors or to their national authorities.
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Policymakers face the dilemma of how best to respond to the challenges of slackening global activity and continued financial volatility without losing sight of their medium-term adjustment needs. In countries with fiscal space, the pace of near-term fiscal adjustment plans should be calibrated to avoid undue pressures on activity and employment. In 2012, deficits in the advanced economies are projected to decline on average by about 1 percentage point of gross domestic product (GDP) in cyclically adjusted terms and slightly faster in 2013. This is broadly appropriate, although countries with enough fiscal space could consider slowing the pace of near-term adjustment to reduce downside risks. Should growth slow further, countries with fiscal space should allow the automatic stabilizers to operate freely and allow the deficit to rise to avoid excess fiscal contraction, which could worsen economic conditions. But short-term caution should not be an excuse to slow or delay efforts to put public finances on a sounder footing over the medium term, as this remains a key requirement for sustainable growth. In emerging economies fiscal adjustment will slow considerably this year. Again, in the context of somewhat weaker growth, this slowing is appropriate, and also in light of the stronger fiscal position of these economies with respect to advanced economies. Over the medium term, however, the fiscal space eroded during 2008–09 should be fully rebuilt, so as to restore flexibility to respond to future downturns.

Against that background, this issue of the Fiscal Monitor examines in more detail the concept of fiscal space, or the scope that policymakers have to calibrate the pace of fiscal adjustment without undermining fiscal sustainability. Among the conclusions that emerge are the following:

• In the short to medium term, many countries remain vulnerable to unexpected shocks, leaving them with little margin for policy errors. Although debt ratios are expected to begin stabilizing by 2015 in the large majority of countries, the risk of a setback is high, constraining policy options.

• In the current recessionary context, the negative impact of fiscal adjustment on activity can be expected to be large, as confirmed by new work on the size of fiscal multipliers during periods of weak economic activity. When multipliers are on the high side, the beneficial impact of fiscal adjustment on debt ratios and spreads may be delayed. This is another reason why, as long as financing allows, a gradual but steady pace of adjustment seems preferable to heavy front-loading. Adjustment should be accompanied by broad and proactive communication strategies to fuel confidence and credibility.

• Since 2008 the rise in general government gross debt ratios may have overstated short-term pressures on the public finances in some countries, primarily because of the surge in seigniorage and the accumulation of assets by central banks (including government paper). This comes to light when looking at consolidated net balance sheets of governments and central banks. However, large central bank holdings of government debt and other assets will need to be liquidated or rolled over to the private sector as the demand for base money returns to more normal levels, meaning that gross general government debt, alongside net debt, remains a key indicator of public indebtedness over the longer term. The process of reducing central bank balance sheets will be difficult to manage without previous or parallel medium-term fiscal consolidation.

• Countries can have flexibility in the short term without having it in the longer term. The need to reduce debt ratios and to address pressures from entitlement spending means that very few countries have long-term fiscal space. The design and implementation of credible medium-term adjustment plans therefore remains a sine qua non for most advanced, and several developing, economies. Progress in this area is accelerating, but there is still a long way to go, including in the largest economies.
A growing number of countries are putting in place fiscal rules. Although they are not a substitute for specific long-term adjustment plans, fiscal rules can build confidence and facilitate the establishment of a political consensus on fiscal policy. Second-generation fiscal rules are typically more complex than earlier versions, providing greater flexibility to respond to economic cycles but with more-binding corrections for past deviations. As such, they also raise significant enforcement and monitoring challenges.

Overall, fiscal risks remain elevated, although there are signs that in some key respects they are less acute than six months ago. Past efforts with fiscal consolidation are beginning to bear fruit, particularly when buttressed by credible institutional commitments. Nevertheless, debt ratios in many advanced economies are at historic levels and rising, borrowing requirements remain very large, financial markets continue to be in a state of alert, and downside risks to the global economy predominate. In this uncertain environment, the challenge for fiscal policy is to find the right balance between exploiting short-term space to support the fragile recovery and rebuilding longer-term space by advancing fiscal consolidation.