

**FISCAL SPACE AND THE AFTERMATH OF FINANCIAL CRISES:  
HOW IT MATTERS AND WHY**

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**ONLINE APPENDIX B**  
**Narrative Evidence on the Motivation for Fiscal Policy in Crisis Episodes**

May 2019

This appendix provides detailed narrative evidence underlying the analysis in Section IV of the paper on the motivation for fiscal policy actions in episodes of substantial financial distress. Specifically, we consider the 22 episodes in our sample where our financial distress measure reached 7 or more.

**A. Source**

The source that we use for this analysis is the Economist Intelligence Unit's *Country Reports*. The EIU is a subscription service providing information on political and economic developments in a wide range of countries. The reports are aimed at investors and other market professionals, and appear to be of reasonably high quality. Each one is around 25 pages, and makes frequent reference to data, legislative debates, and political developments. The service relies, in part, on the reporters and analysts working for the *Economist* magazine for its information. Because the reports focus particularly on policy actions, we find them to be a plentiful source on the motivations for those actions.

The EIU *Country Reports* after 1996 are available from EIU.com; those before 1996 are available from the Economist Intelligence Unit Country Reports Archive through ProQuest. The reports are available quarterly until early 2000, and monthly thereafter. The reports for the first quarter (which came out in early January) and the third quarter (which came out in early July) are roughly comparable in timing to the *OECD Economic Outlook*, from which we derive our measure of financial distress (the *Economic Outlook* generally comes out in December and

June). When the reports become monthly, we treat those for January and July as the parallel to the OECD volumes.<sup>1</sup> Our approach is to read the EIU *Reports* for a country corresponding in timing to the OECD *Economic Outlook* starting in the half-year before financial distress reached 7 or above. We read nine issues for each episode of high distress—two a year from one half-year before the crisis to four years after.<sup>2</sup>

## **B. Approach**

In reading the EIU *Reports*, we look at what they say about four questions:

1. What is the current and/or prospective stance of fiscal policy?
2. What is the motivation given for the fiscal developments?
3. Does the EIU mention the debt-to-GDP ratio as a concern or as an underlying motivation?
4. Is there anything else of note relevant to fiscal policy actions?

From the answers to question (1), we identify whether fiscal policy at the time was perceived by the EIU to have been on net expansionary or contractionary, and whether the net movement was large or small. The overall direction of fiscal policy is usually stated quite directly. To categorize size, we rely mainly on adjectives. Fiscal moves described with words like “mild,” “minor,” and “small” are classified as small; those described with words like “enormous,” “unprecedented,” and “extreme” are classified as large. This scaling is obviously rough. In the tables in the paper that summarize the narrative evidence, we therefore note cases that are marginal for a category.

In classifying the motivation given by the EIU for fiscal actions (question 2), we are open to nuance and multiple motivations. For fiscal expansions, we identify three possible motivations:

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<sup>1</sup> We do this in part for consistency with the early years of the EIU *Reports*, and in part because, for a transition period, the December and June issues are updates rather than full reports. In addition, there are a few irregularities in which EIU reports we consider. For example, the report for Sweden for 1994Q1 is not available from ProQuest. Similarly, in a few cases in the early 2000s, the January and July issues are updates and the December and June issues are full reports. In such cases, we use a rule of reason and read the obvious alternative report.

<sup>2</sup> In the case of Japan’s crisis, where financial distress first reached 7 or more in 1997:2, then fell to low levels, and later returned to 7 or more in 2001:1 and 2002:2, we read eleven issues rather than nine so that our analysis covers the second spike in financial distress.

- a. Financial rescue.
- b. Countercyclical stimulus.
- c. Politics.

The EIU typically says why some fiscal action was taken, not why some other action was not taken. That is, the counterfactual is implicitly or explicitly neutral fiscal policy. As a result, market access is inherently not an explanation for fiscal expansions, and all of the possible motivations correspond to policymaker choices. Actions taken for countercyclical stimulus or financial rescue can be thought of as reflecting policymakers' ideas: policymakers take the actions because they believe the policies will be helpful. "Politics" (category c) refers to fiscal stimulus taken to try to help win an election.

For fiscal contractions we consider five possible motivations:

- d. Market access.
- e. Conditionality imposed as part of a bailout.
- f. Policymaker ideas.
- g. European Union fiscal rules.
- h. Countercyclical austerity.

"Market access" captures austerity that the EIU identifies as being driven by very high sovereign spreads, inability to borrow, or other problems with private sovereign funding. The final three motivations correspond to policymaker choices. As described above, policymaker ideas and EU rules largely differ in *whose* ideas are mattering—those of domestic policymakers or EU officials. "Countercyclical austerity" (category h) refers to contractionary fiscal actions taken to prevent overheating, and can again be thought of as a special form of policymaker ideas. Finally, "conditionality" is the hybrid of market access and IMF (or other bailout organization) choices discussed in the paper.<sup>3</sup>

Question (3) reflects both information about policymakers' concerns about the debt-to-GDP ratio in an episode and the EIU's perspective. We take note of the EIU's assessment on the grounds that when we do not have direct information on policymakers' views, it at least provides

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<sup>3</sup> Not surprisingly, the motivations given in the EIU *Country Reports* occasionally do not fit into one of the eight categories we identify. In these cases, we note an "other" motivation, which we label as (i) in what follows.

the assessment of one contemporary informed observer of whether debt was important. However, we put the main emphasis on the information the EIU provides about policymakers' views. We pay particular attention to whether the EIU believes that the debt-to-GDP ratio is driving the proximate motivation—for example, whether it cites the debt-to-GDP ratio as something that is affecting market access or policymakers' ideas.

### **C. Episode-by-Episode Descriptions**

The remainder of this appendix provides our detailed notes and selected quotations for each EIU country report that we read, organized around the four questions discussed above.

## EPISODE-BY-EPISODE DESCRIPTIONS

### UNITED STATES (1990:2)

#### **1990Q3 (pre-crisis):**

1. Perhaps slightly contractionary. According to EIU, there is a consensus that the deficit needs to come down despite a weak economy. But Iraq invaded Kuwait roughly 6 weeks before the report, and there's also a consensus for more military spending and somewhat less focus on the deficit than there had been.
2. (d) and (f). (d): "budget crisis," a "risk of a collapse in financial confidence"; failure to act promptly "might unsettle the foreign exchange markets"; Fed won't cut interest rates until it sees how financial markets react to a budget agreement; "Unless the package is substantial, it is possible the financial markets will not allow a cut in interest rates at all"; "the USA may not be able to obtain the funds it needs unless it keeps its interest rates high"; "USA's external debt position worries Congress" (though this last isn't specifically about government debt). (f): Greenspan thinks the deficit needs to come down; EIU acts as if there's consensus on this between the president and Congress, though it doesn't give specifics.
3. Nothing additional.
4. Weak economy; Gulf crisis.

#### **1991Q1:**

1. Contractionary, though not sharply. A budget agreement in October 1990 does various things to put the deficit on a declining path. However, there is no large immediate contraction. And there is additional spending from the S&L bailout (which is just the consequence of earlier legislation, not new decisions), and there are costs associated with the Iraq war that are temporarily adding to the deficit. But, the EIU sees the overall trajectory of fiscal policy as contractionary.
2. (f) and (i)? EIU says almost nothing.
  - The *previous* issue provides lots of evidence for (d), but the only discussions of financial market confidence in this issue are a few statements like, "The psychological impact of the successful outcome of the war has boosted the dollar which means that for the time being there is no need for concern over the international and exchange rate implications of lower interest rates." Thus, there's *no* evidence in this report for (d).
  - The previous issue also has some evidence for (f). To the extent that (d) is less of a concern, this supports (f). Likewise, some later issues support (f) in terms of the general fiscal trajectory, again consistent with the view that it's important here.
  - The "(i)" theory would be that there's a perception that monetary policy is better suited to short-run stabilization, and that fiscal policy can therefore address the long-run issues, and the high deficit is viewed as a long-run problem. ("The actions of the Federal Reserve are an important component in US economic policy, because the Fed can react quickly to changing economic circumstances, while the process of setting a federal budget is slow and laborious.") Arguably, this is an idea, and so falls under (f), but it's very different from the usual ideas.
3. No. (In this issue, the EIU does not appear to ever say the deficit is a problem, despite the near-hysterical tone in the previous issue.)
4. Recession; fears of continued "credit crunch" and possibly "a disaster in the banking industry."

**1991Q3:**

1. Contractionary. There are a few short-term things going on from the Iraq war and its aftermath, but the general trend is contractionary in the wake of the 1990 budget agreement. Again, does not sound strong. For example, "Government spending will be restrained by budgetary difficulties."
2. No new evidence to speak of. So, a mix of (f) and (i)?
3. EIU says once that the deficit is a problem. Also, "the sheer size of the debt makes it difficult for the federal government to contemplate any major spending initiatives in the near future." They don't cite any policymakers as holding these views, though perhaps it's implicit in the budget agreement.
4. Economy is recovering. (Aside: "whoever wins the Democratic nomination will face an almost impossible task.")

**1992Q1:**

1. Expansionary.
2. (c) and (b). Various short-term expansionary measures, plus a complicated set of longer-term changes and proposals in both directions that the EIU isn't very clear about. Regarding the short-term expansion, EIU says, "fiscal policy is suffering from election fever," but also refers to "temporary recession fighters" (the economy is early in the recovery). Regardless, the scale seems small. Plus, there's some contraction from reduced defense spending.
3. There are a bunch of references to the deficit as a long-term problem. "[M]ost politicians know that something will have to be done about it"; "huge federal deficit"; "when action to reduce the budget deficit again becomes urgent." One mention that "The \$400 bn federal budget deficit is flooding the financial market with Treasury paper. Lately, the Federal Reserve banks have been absorbing much of it, but more will soon be sold on the public markets." But no indication that there's any actual problem with market access, and no clear indication that any of this is affecting policy.
4. One piece of support for "(i)" for the previous two reports: "the administration is relying on the Federal Reserve Board's easy monetary policy to bring recovery." (Also, "The credit crunch ... is now over.")

**1992Q3:**

1. Roughly neutral. EIU says "few fiscal policy changes" a couple of places. The candidates for president have various proposals, some expansionary and some contractionary, but nothing is being done. EIU does say, "fiscal policy is still constrained by the straitjacket of the Omnibus Budget Reconciliation Act," but they don't point to any concrete effects.
2. Not applicable (since no changes).
3. EIU says that the deficit is a big problem, and, "With a large federal deficit, major social initiatives have been impossible."

**1993Q1:**

1. Slightly contractionary? The EIU isn't very clear or coherent. They seem to be seeing "short-term fiscal stimuli ... in 1993," followed by "tighter fiscal and monetary policies ... in 1994," with more emphasis on the generally contractionary trajectory starting in 1994 than some stimulus in 1993 (for example, "President Clinton is trying to tidy up a fiscal mess"). But at other times, they talk as if there's a mix of proposed actions that on net won't have any clear effects.
2. (f)? EIU doesn't provide much information. Everyone (EIU and policymakers) seems to take it as given that the deficit is a problem that needs to be dealt with.

3. EIU sees the general budget situation as a limiting what policymakers can do (“there is little budgetary freedom”). One mention of the level of debt: “the Urban Institute is forecasting the burden of debt, as expressed by the debt/GDP ratio, to rise.” And there are a few comments that have a tangential relation to market access, but nothing that even implies that it’s actually an issue. (“[R]ates may start to come down if progress is made in reducing the budget deficit”; “worsening current-account deficits ... may encourage” fiscal tightening).

### **1993Q3:**

1. Contractionary. A budget agreement that will cut the deficit by 2% of GDP relative to what it otherwise would have been; “What had started off life as a radical, reforming package ... has become a rather grim deficit-reduction programme.”
2. (f)? EIU doesn’t provide much information. Everyone (EIU and policymakers) seems to take it as given that the deficit is a problem that needs to be dealt with.
3. EIU still sees long-run budget problems: “The federal deficit will shrink only slightly, with debt continuing to be built up. ... [R]ising levels of debt will have long-term implications for interest rates and the external account.”

### **1994Q1:**

1. Contractionary. “The Clinton administration has proposed a tough budget for fiscal 1995”; “severe austerity”; “Although the proposals have to be debated in Congress, the final package that is agreed will keep the real level of federal expenditure on its downward trend”; “There are no major policy changes contained in the 1995 budget, but constrained by budget caps on discretionary spending ... introduced last year.”
2. (f)? Basically a continuation of the previous approach to policy. EIU does not say anything about the reasons. Clear that policymakers want to reduce the deficit (discussion of Clinton “[delivering] the promised decline in the budget deficit”).
3. No discussion of the level of debt, or of the deficit as a problem. The closest the EIU comes (which isn’t very close) is, “the current-account deficit in 1994 will be equivalent to just over 2% of GDP, and there will be no immediate difficulties in financing it.”

### **1994Q3:**

1. Contractionary. “[F]ederal expenditure [by which the EIU appears to mean federal government purchases of goods and services, since it’s only 7% of GDP and mainly defense] will fall again.” New actions seem small. The strongest statement is, “The impact of budget-cutting measures continues to prove more dramatic than previously forecast.” But that seems to be mainly about the effect of past actions; and the numbers they give are not huge.
2. (f)? A continuation of previous policies. EIU doesn’t say anything about the reasons. Again clear that policymakers want to reduce the deficit. (“[T]he Clinton administration seems to be sending to bond markets the message that its fiscal stance is not softening”; administration touts “the success of Mr Clinton’s 1993 deficit reduction package.”)
3. No discussion of the level of debt, or of the deficit as a problem. A long discussion of the reasons for the dollar’s recent sharp fall against the yen (described as an “attack” and a “run”) noticeably fails to include any mention of fiscal policy or concerns about public finances.

**Bottom Line: Fiscal policy in the U.S. was basically moderately contractionary throughout. It was driven by two ideas of domestic policymakers. One was that deficits and debt were bad and that the deficit needed to be reduced. The other was**

**that short-run stabilization was best left to monetary policy, which freed fiscal policy to focus on the long-run fiscal outlook and other long-run issues. There was a tiny bit of fiscal expansion in 1992 driven by countercyclical and political motivations.**

## **NORWAY (1991:2)**

### **1991Q3 (pre-crisis):**

1. Expansionary. "The budget remains expansive." EIU isn't very clear about size. Says the budget will add "1.5 per cent to GDP growth this year (compared with 1.25 per cent in the budget proposed in December)". Also says that the deficit is projected to increase from roughly 1% to roughly 3% of GDP. So sounds moderate.
2. (b): "A revised budget includes a package to tackle the growing problem of unemployment."
3. Debt not discussed. But the government is concerned about the deficit: "The large rise in the non-oil deficit has strengthened the government's determination to curtail the steep rise in transfer payments of the past few years."
4. "The troubles of Norway's banking sector have continued."

### **1992Q1:**

1. Expansionary. EIU doesn't say anything explicit about the size. But, "The 1992 budget containing a record deficit has been adopted by the Storting" (though some of the high deficit is due to falling output). And, "The estimated combined total losses incurred by all commercial banks (and entirely covered by the government) came to Nkr16 bn (\$2.5 bn) in 1991" (2.3% of GDP). So, sounds substantial.
2. (a) and (b). (a): "The government has been busily helping the banks out of their deepest crisis in 50 years." (b): "The government has announced an expansive budget ... in a bid to stimulate demand"; "A downward revision of economic forecasts ... were the reasons for the expansionary programme."
3. No.
4. Ongoing banking crisis. The oil sector makes it easier to do fiscal expansion: "These tax cuts ... will, together with the budget deficit, be effectively underwritten by the offshore sector."

### **1992Q3:**

1. Expansionary. (Not clear that any important changes since the last report. There has been no change to the projected nonoil deficit, though the total deficit is expected to be higher because of lower oil prices. And, "Troubled banks receive some more help," but that doesn't appear to involve more government spending.)
2. (b). "A large budget deficit is being run this year. ... [E]xtra money is being made available for employment creation measures."
3.
  - Deficit is a problem: "The upward revision of the budget deficit ... has attracted stern warnings from Norges Bank, the central bank" (EIU also implicitly criticizes the deficit).
  - Mention level of debt/deficits as a potential problem: "The government can be expected eventually to reduce spending in a bid to cut the deficit. Otherwise, its current net asset position would transform into one of net debt, with the painful belt tightening exercise that such a scenario would entail."
  - Mention international considerations: "considering the government's intention to apply for EC membership, the convergence criteria of the Maastricht treaty signed by the 12 member states of the Community in December 1991 require that the public sector deficit be kept to a maximum of 3 per cent of GDP. Norway's total deficit in 1992 will be around twice this proportion. Moreover, the trend is towards an increase, and this will have to be reversed if Norway wishes to be among the core economies of the EC." Not linked to actual policy, however: "However, the

government seems quite content to run wide deficits.”

4. Ongoing banking crisis. The oil sector makes it easier to do fiscal expansion: “the offshore economy continues to pay for the ills of the mainland economy.”

#### **1993Q1:**

1. Expansionary. There is a “[c]risis package ... to improve competitiveness” that includes both expansionary and contractionary elements. However, the EIU’s overall tone is that policy is expansionary.
2. (b), (a), and (c). (b): “the rise in government expenditure and specific measures aimed at the unemployed”; “The 1993 draft budget ... aims at increasing the number of places on job schemes and in universities, as well as bringing forward some public works. Moreover, the December crisis package seeks to create 5,000 new jobs.” (Note that Norway’s population was roughly 4.3 million, so 5000 jobs is substantial. (a): “Further state aid is forthcoming for the banks.” (c): “some pre-election extra spending is a likelihood.”
3. No.
4. Ongoing banking crisis. Oil revenues help pay for the non-oil deficit.

#### **1993Q3:**

1. A bunch of actions and proposals, but generally small and in no clear direction.
2. Expansionary: (c) (mainly) and (b). Contractionary: (f) (high/rising deficit are a concern in their own right). (c): “The government, which had proposed cuts last autumn of Nkr5bn in state benefits as from 1994, cannot afford to do so now as it is trailing in the opinion polls and a general election is coming up in September. Cuts of half that amount (Nkr2.5bn) are therefore being proposed instead.” (b): “The problem of joblessness is causing great concern .... Government policy in Norway is more active than” in most Western European countries. (f): “belt-tightening on the part of the government”; seems to be motivated by the high deficit, and perhaps a sense of an overly large government sector.
3. Say that the deficit is a problem.
4. A major reason for the rising deficit is falling oil prices.

#### **1994Q1:**

1. Expansionary.
2. (b): “the key aim is to cut unemployment.” “Unlike its Nordic neighbours, the government has not felt the need to introduce austerity measures to bring down the deficit, which has increased sharply in the last couple of years.”
3. No.
4. Deficit as share of GDP is falling, but fiscal policy is described as expansionary, and document says that the government isn’t undertaking austerity measures. (It also says that growth is very high, which may be one reason for the falling deficit.) Support to banks is being wound down; banks are being reprivatized. Oil revenues help pay for the non-oil deficit. There’s a new government that’s more left-wing, which appears to be a reason for the switch to trying to use stimulus to bring down unemployment.

#### **1994Q3:**

1. Contractionary. Appears small: Overall revision in the deficit (which is downward) is about 0.6% of GDP, but some of that is from growth and/or higher oil revenues; sum of the measures the EIU lists is about 0.2% of GDP.

2. (f). High deficit is a concern in its own right: “policymakers are having to concentrate on potential long-term problems. One of these is the budget deficit.” Perhaps a little bit of (h) (improving economy): “support for labour-market measures will be cut by Nkr675m [0.1% of one year’s GDP] in the next two years, a sign that the government is confident about the prospects for employment growth.”
3.
  - Allude to international considerations (g): Norway has interest in joining the EU, but its deficit is above the EU maximum. Not linked to actual policy, however.
  - Vaguely allude to market access (d): say that the market monitors the central government deficit. (This is said in the context of the EU discussion.) Again, not linked to actual policy.
4. Oil revenues help pay for the non-oil deficit.

### 1995Q1:

1. Contractionary. Again appears small: the lower deficit is attributed mainly to faster growth and higher oil prices, and the specific measures the EIU lists are small.
2. (h) (economy is very strong). “[A]s growth accelerates the government will *continue* to introduce spending cuts in a counter-cyclical fashion” (emphasis added). “The fiscal stance will still be held tight, ... with counter-cyclical cuts bolstering the budget balance. Norway has been unusual among western European countries over the past two years in that it implemented counter-cyclical policies throughout, and resisted deep cuts in spending in 1993-94. Now as growth is picking up it finds itself in a position to make the necessary cuts.”
3. No.
4. Rapid growth and rising oil prices are helping to reduce the deficit.

### 1995Q3:

1. Mildly contractionary. Deficit is falling and headed toward surplus. Some of that is from a strong economy, but some is from steps to slow or cut spending: “tight counter-cyclical control of government spending.”
2.
  - (h). Output is growing rapidly, unemployment is falling, and inflation is rising. EIU refers to “the continuation of a counter-cyclical fiscal policy, which helped steer Norway clear of the recession in the early 1990s and is now being used to cut back public spending and reduce the risk of overheating.” Also, “Revenue is budgeted to rise by 4.8% in nominal terms, while spending has been cut by some 1.7%, after a rise of 2.1% in 1994. This cut during a period of growth underlines the determination of the government to keep spending under control and prevent the economy from overheating.”
  - There’s also a hint of (d). Norway recently voted against joining the EU, which led to fears of capital flight. For example, “Both government and industry have been concerned that the referendum vote against membership of the EU would lead to a flight of investment capital out of the country, particularly into Sweden, which joined the EU on January 1, 1995. It is still early days, but such an effect has so far not been apparent, nor is there any sign of an exodus in the future.” And, “it will need to display great robustness and stability if it is to succeed in attracting capital from abroad and maintaining investor confidence.” But the EIU does not explicitly tie these concerns to fiscal policy.
3. A few passing mentions that Norway’s debt position is good.
4. There were some floods that led to some one-time spending, and a tax reform that will reduce revenue slightly. But the EIU doesn’t view these as central to fiscal policy.

**Bottom Line: Norway undertook moderately expansionary fiscal policy until well after the crisis for countercyclical purposes and financial rescue. Policy then turned mildly contractionary. The shift was partly the result of policymakers' belief that fiscal rectitude was desirable (despite Norway's extremely strong fiscal position), and partly a countercyclical response to strong growth.**

## **FINLAND (1993:1)**

### **1993Q1 (pre-crisis):**

1. On net expansionary because of substantial financial rescue, but conventional policy is contractionary.
2. (a) (and a little (b)) on the expansionary side. On the contractionary side, (h) (combating inflation), and (f) (not completely clear, since the EIU isn't explicit, but the austerity seems to be an ideological view of the government).
  - (a): A bank bailout that will initially cost 4% of GDP and could ultimately cost about 14% of GDP. "[P]arliament approved a motion saying it would grant sufficient funds and authorising the government to use them to secure 'under all circumstances' the continued operation of Finland's banks. ... Under the scheme, the government hopes to avert a credit crunch and collapse of the banking sector."
  - (b): There's also a passing reference to a stimulus package of 1% of GDP: "The cuts come despite the unveiling ... of a stimulation package of Fmk4bn to boost investment and construction." (This is smaller than the various cuts described elsewhere, however.)
  - (h) and (f): "The budget envisages wide-ranging reductions in every sphere of state participation in order to contain inflation and capitalise on an export-led recovery."
3. Mention the debt, and say the government views the level and the rapid rise as a problem. "The government has promised to curb borrowing and tackle Finland's burgeoning debt crisis, but has shown little progress in doing so." (This is in the context of the current account, so it's not 100% clear that this is government debt.) The report also mentions that the high deficit is above the limit for joining the European Community, and that the debt is approaching the limit, though it doesn't make a big deal of these things.
4. Ongoing banking crisis.

### **1993Q3:**

1. Contractionary (spending cuts of 2% of GDP, tax increases of 2% of GDP). Plus a further bank bailout (also 2% of GDP).
2. (f): "The main priority, according to a government statement, is to reduce unemployment by stimulating the private sector"; "The centre-right government unveiled a tight budget proposal ..., aimed at lowering interest rates and reducing unemployment. ... The budget is intended as part of a drive to ensure that state debt does not rise beyond 70% of GDP." Plus (a): "A consensus has already been reached to rescue the troubled banks."
3. The government clearly views the debt and deficit as problems. No mention of European rules. No mention of interest rates other than the one above.
4. Ongoing recession and banking crisis.

### **1994Q1:**

1. Overall goal is contractionary ("Balancing the government's finances is the main policy concern"), but recent actions have been expansionary at the margin.
2. Little information about policymakers' motivations, perhaps because little is happening on the fiscal front. But (f) is probably the main source of the overall contractionary goals and (b) and (c) (high unemployment, a precarious political position for the government) the main sources of the recent actions for expansion. "Measures are included [in the revised budget] to boost investment and employment."
3. Repeatedly mention the debt as a problem (for example, "the size of the public debt is still central to Finland's economic problems"), but don't explicitly attribute this view to

the government.

4. Economy may have reached the trough. Barely any mentions of the banking crisis, and those are positive (diminishing bank support fund; rapidly rising prices of bank shares). Mention that properly measured, the deficit is smaller than normally reported (and, it appears, lower than they've been reporting).

### 1994Q3:

1. Overall goal is contractionary, and the draft budget cuts overall spending. EIU gives no clear indication of the size. It acts as though the government is very focused on fiscal consolidation, and at one point refers to "the present government's draconian social spending cuts." But also says, "There is concern that the cuts proposed in the draft budget for 1995 might not be large enough." There have been some recent steps that are expansionary at the margin, however. (But the only one that's described concretely is just a few tenths of 1% of GDP.)
2.
  - (d) (concern about international financial markets and the possibility of higher interest rates): "The main concern of the government is the large (and expanding) size of state debt. And with long-term interest rates rising, that concern becomes all the more pressing. ... The finance minister, Iiro Viinanen, cautioned that if spending was not contained to the present budget forecast, interest rates would rise to the detriment of economic growth." "[I]t is the debt that is causing the worry among financial investors." EIU says the high level of debt leaves the government with "little choice" but to pursue austerity, though not precise about why.
  - Some (f) as well. For example, EIU implies that "the present government's draconian social spending cuts" were ideologically-driven. The president "has been quick to reassert that the problem [of high unemployment] cannot be combated by more state borrowing." Motivation for the expansionary measure is (b).
3. Mention EU rules (in passing): "participating in the process of economic and monetary union in Europe demands fiscal discipline."
4. Banks are recovering slowly. Also, these notes focus on the current government, not the EIU's views about what the likely winner of the upcoming election will do.

### 1995Q1:

1. Contractionary. Not clear that a lot new is happening, but, "The government's fiscal policy remains predicated on the need for austerity," and government spending as a share of GDP fell by 2.4 percentage points from 1993 to 1994.
2. (g) (European rules), (h), probably some (f), a possible hint of (d).
  - (g): "the need to reduce the burgeoning state debt and the wide budget deficit, both of which are well in excess of that permitted by the Treaty on European Union"; "There is no alternative to a policy directed towards austerity, particularly as Finland is probably going to aim for participation in Economic and Monetary Union (EMU)"; and more.
  - (h): "the underlying threat of inflation is never far from policy-makers' minds ..., and as soon as Finland's economy expands then the need for countercyclical spending cuts will become more apparent." (The economy is growing strongly.)
  - (f): "The government's fiscal policy remains predicated on the need for austerity in an attempt to reduce the budget deficit and break out of the public-debt spiral."

- (d): “Interest rates have come under pressure.” But later, this is attributed to expected inflation, not a risk premium: “The financial markets have been concerned about the prospects of inflation returning to Finland in the next few years, as witness the recent rise in long-term interest rates.”
- 3. Repeatedly mention the debt and its rapid rate of increase as a problem.
- 4. These notes focus on the current government, not the EIU’s views about what the likely winner of the upcoming election will do.

**1995Q3:**

1. Substantial austerity. “The Lipponen Social Democrat-led coalition came to power in March committed to cutting public spending by FM20bn (\$4.7bn), or 4% of GDP, over the next four years.”
2. (g) (desire to join the EMU) and (probably) (f) (lower deficit seems to be a general goal of policy; also, policymakers want to cut spending so they can cut taxes, which sounds idea-driven). “Economic policy will be driven by the government’s determination to take part in the third stage of Economic and Monetary Union (EMU), which a core of EU countries plan to undertake in 1999. The most immediate threat to Finland’s qualifying for inclusion is its public debt .... Fiscal policy will therefore remain tight.” (There’s lots more along this line.) “[T]he government’s drive to bring down the budget deficit.” “A supplementary budget which cuts social spending and agricultural subsidies was passed. ... [T]here may be some income tax cuts.”
3. Mention the level of debt and the fact that it has risen a lot.

**1996Q1:**

1. Not clear. There is a marginal move toward expansion, but the EIU says the budget is following the long-term fiscal programme, which is definitely austerity.
2. The report says little. But (g) (EMU rules) are prominent. “The 1996 budget forms part of a long-term fiscal programme, one of the aims of which is to ensure that Finland qualifies for the third and final stage of Economic and Monetary Union (EMU)”; “The principal policy aims remain halving the unemployment rate by 1999 and meeting the convergence criteria by 1997 for EMU entry.” The motive for the marginally expansionary moves is (b).
3. Mention the level of debt, but almost entirely in the context of EMU rules.
4. Economy has weakened.

**1996Q3:**

1. Substantial austerity. “The government’s draft budget for 1997, which was adopted by the cabinet in August, envisages a reduction in public expenditure on 1996 equivalent to 3.8% of GDP.” And see the reference to “swingeing cuts” below. (There’s also a proposed income tax cut, but it’s smaller than the spending cuts.)
2. (g) (EMU rules) are central: “the swingeing cuts in public expenditure which the government is having to make to meet the Maastricht criteria”; “Meeting the convergence criteria for participation in the third stage of EMU ... will be the overriding aim of economic policy over the next 18 months”; “The convergence criteria for EMU dictate fiscal policy”; etc.
3. Mention the level of debt and its rise, but almost entirely in the context of EMU rules.
4. Economy has weakened. The pursuit of a 3% deficit leads to procyclical fiscal policy—a weaker economy leads to tightening.

**1997Q1:**

1. Substantial austerity. “Parliament has adopted the budget for 1997, which aims to reduce

the general government budget deficit to 1.4% of GDP” (from 2.9% in 1996). “The macroeconomic policy stance will be tighter in 1997 than in 1996. On the fiscal policy front, the 1997 budget, which was adopted by parliament in December last year ..., left the overall tax/GDP ratio broadly unaltered but provided for a 3.5% nominal cut in public expenditure. Although income taxes were also cut, the overall impact on the government’s fiscal stance was mitigated by an increase in indirect taxes (notably energy taxes).”

2. (g): EMU rules play a key role in driving contractionary fiscal policy. “Paavo Lipponen (SDP), and the finance minister, Sauli Niinisto (KOK), share a pro-EU outlook and are both firmly committed to Finland joining the single currency with the first wave of countries in 1999.” “Eligibility to join the single currency will be determined in 1998 by reference to fiscal performance in 1997. The 1997 budget was therefore primarily designed to ensure that Finland meets the criteria outlined in the 1992 Treaty on European Union (the Maastricht treaty) on public finances.”
3. “Finally, although the debt/GDP ratio will almost certainly be above the Maastricht reference value of 60%, Finland will be adjudged to meet the criterion on the grounds that its debt is ‘sufficiently diminishing and approaching the reference value at a satisfactory pace’ (Article 104c of the Maastricht treaty).”
4. “Interest rates have remained low and the differential with German rates has continued to fall.” “At the longer end, yields on Finnish ten-year government bonds fell so sharply in the fourth quarter of 1996 that the differential between Finnish and German yields, which had stood at around 150 basis points in 1995, was reduced to 40 basis points.”

**Bottom Line: Finland initially undertook a large fiscal expansion for financial rescue. Otherwise, fiscal policy was contractionary throughout, often strongly so. The first contractionary moves stemmed from policymakers’ beliefs that deficit reduction and low debt were beneficial. Later, a desire to join the EMU was also important. Market access was mentioned, but was confined to two reports and emphasized only in one.**

## **SWEDEN (1993:1)**

### **1993Q2 (pre-crisis, 1993Q1 would not open):**

1. "The economy's huge budget deficit will be reined in only slowly as an economic recovery takes root." "[D]eficit of some 13% of GDP." Down from 14%.
2.
  - May be a role for ideas (f) and/or market access (through interest rates) (d): "Carl Bildt is sticking to his fundamental course of cutting the state sector and reducing the burgeoning budget deficit—which as a percentage of GDP is likely to remain the highest in the OECD area in 1993. His determination has instilled a greater sense of certainty in the markets, and this in turn is taking pressure off interest rates." "Cuts in the structural side of the deficit are being applied with as much determination as is feasible in the currently precarious political setting." "Conservatives, who favour deep cuts in Sweden's generous social security system."
  - Financial rescue (a): "The government has already put up Skr67.5bn, or the equivalent of 5% of GDP, to support three banks." "The problem is complicating attempts to reduce the budget deficit."
3. "Other long-term aims include: stabilising public debt at 40-50% of GDP by 1998 (on current trends the ratio would reach 70% by the end of the decade!)."
4. "The banking crisis persists."

### **1993Q3:**

1. Deficit is 13% of GDP, and "new corrective measures have had to be taken." "The banking crisis has been a large burden on government finances." "Still, expenditure-restraining measures have had to be taken." Describing cuts of over 10% of GDP.
2.
  - (a): Main reason for big spending is the financial bailout. "Its determination to prop up the [banking] system has been an important cause of the widening budget deficit." It does not sound as though there is much conventional countercyclical motivation.
  - (d) or (f): The government is tightening (cutting other types of spending and raising revenue). Following a discussion of attracting capital, the EIU says, "The central government wants to keep up this level of enthusiasm. Luckily, its credit rating is still good and should remain so." So, it could be that policymakers feel they need to take austerity to keep up the enthusiasm. But, the EIU seems to say that things are fine, which would suggest ideas are more important.
3. EIU says, "The budget deficit will pose problems." Sweden's long-term government bond rates have fallen from 10% in Jan. to 8% in July. Quite high relative to other European countries (because of threat of inflation and the need to attract capital into the country to help finance the deficit).
4. Much discussion of the costs of financial rescue (so far about 5% of GDP).

### **1994Q2 (1994Q1 would not open):**

1. "The cause of the deficit has been a combination of high transfer payments, debt servicing and sluggish tax revenue. In addition, the impact on spending of the outlay of some Skr50bn in 1992 to help the ailing banking system left a deep hole in public finances." "The finance ministry has effected cuts in welfare spending, but does not foresee a stabilisation in the debt until 1998 at the earliest. Calls have been made for a much tougher austerity programme than any introduced so far."
2.
  - (a): Certainly financial rescue is a part of it. (see (1) above). Notice that the spending on rescue was described as having occurred in 1992.

- (f): Ideas also seem important. EIU says government was pushing some austerity from its start in office in Sept. 1991 (despite the fact that economy was headed into recession). “Mr Bildt’s government erred in its judgment, by setting about the trimming of arguably the world’s most elaborate welfare system at a time when it was most needed.” And, “Confounding the expectations most analysts had of the Conservative prime minister ..., whose declared mission was to reduce public expenditure, public consumption fell by only 0.7% in real terms in 1993.”
  - (c): Politics may also play a role. Finance minister says austerity is the maximum conceivable for a minority government facing a general election.
3. EIU mentions rise in debt from 49 to 67% of GDP.

### 1994Q3:

1. Expecting a change in government and a little less austerity. Current government announced a modest cut in spending and some tax cuts.
2. (g): Conditionality due to European integration is a driving force. “Fiscal rectitude is a prerequisite of European integration.” (f): Perhaps ideas. “The Social Democrats will be constrained by their commitment to reduce the fiscal deficit, ... and to bring down the government debt, which stood at around 80% of GDP in June.” “The Social Democrats believe that budget austerity since 1991 has had the effect of depressing aggregate demand and exacerbating the unemployment problem.” So, the EIU is expecting them to be a bit less austere.
3. “Rising government debt is the main problem.” This appears to refer to why the deficit is large. “Swedish budget finances are thus increasingly sensitive to trends in foreign interest rates.”

### 1995Q1:

1. “The Social Democratic minority government has presented a tough budget that should see Sweden’s public debt stabilise by 1998. A mini-budget of further spending cuts ... could be produced in April.” “The government has presented a tough budget that envisages financial savings worth some 7% of GDP.” New government is committed to reducing the deficit and stabilizing the debt over 4 years. “Reducing the budget has become the single-most pressing issue of government, according to the finance minister.”
2.
  - (d): Market access might play a role. Seems like they want to reduce interest rates. Mention of “persuading the financial markets.”
  - Also (f): Partly on the part of the public: “In the end, the electorate gave his party the victory it sought, not so much because it wanted a return to the days of full employment and social security, but because it judged that the SDP was more capable of delivering ... tightening up the government finances and stabilising the public debt.” Partly through the government: policymakers seem to think austerity will be good for growth (though perhaps by lowering i).
3. “Government debt has continued to rise.” Everyone saying high debt is bad (though it is not completely clear why they think so). “The Persson budget indicates that the Social Democratic government is prepared to face up to Sweden’s tough economic predicament. The old remedy of stoking up inflation to reduce state debt is clearly no longer acceptable.” “The core concern of the government in reducing its deficit is to bring the public debt under control.”

**1995Q3:**

1. Severe austerity. Sweden's general government deficit is 10% of GDP; Maastricht criteria is 3% by 1997.
2.
  - (g): much talk of EMU convergence plan. The government seems to be trying to meet the criteria. "The government is bullish about the fiscal outlook. Its EMU convergence plan presented in June includes new savings measures to be introduced."
  - Also (d): "But since the election the SDP, faced with a burgeoning fiscal deficit and rising public debt, as well as highly sceptical international financial markets, has been forced to implement an austerity programme that is arguably harsher than that which led to last year's heavy defeat of Carl Bildt's Conservative-led government." "The financial markets appear to have taken a more positive attitude towards Sweden of late, thanks to the prospect of an accelerated privatisation programme, but remain sceptical about Sweden's ability to meet the convergence targets for ... EMU." "The government is aware that the key is to reduce the budget deficit, as only then will it be able to obtain favourable credit conditions and reduce its public debt. Yet, despite its deep cuts in spending ... the government still lacks credibility in the eyes of the financial markets."
3. Everyone seems to agree that high debt is a problem. Bond yields have come down some.
4. EIU says austerity is delaying a full recovery of consumer spending.

**1996Q1:**

1. "The public-sector deficit in 1995 is estimated to have been under 7% of GDP." Pressure to ease back on austerity.
2. (c): there seems to be a bit of easing a bit to deal with political problems. "Mr Persson has made some concessions on fiscal policy to the left wing of the party in the run-up to the special congress to confirm his selection as prime minister." (d): The discussion of the rise in interest rates when there was some softening of austerity (see 3) suggests market access could be an issue. The EIU certainly talks as if that is one of the things driving PM not to reduce austerity more.
3. "Demands have already been made for a softening of the present tight budget policy .... The first indications of increased flexibility came in January, when he announced a couple of U-turns, with plans for a modest rise in unemployment benefits and higher taxes for the top income earners. ... The immediate reaction was a rise in interest rates and a weakening of the krona. Although foreign investors stood firm with their Swedish assets, international credit appraisals signalled a possible reduction of ratings for Sweden. This revealed signs of the apprehension with which financial markets regard Swedish economic policy."
4. Swedish banks have recovered surprisingly quickly. The former finance minister (who did the harsh austerity) has become the prime minister.

**1996Q3:**

1. Reference to draconian spending cuts of previous government from 1991-94. Current policy is a little more austerity. Under the heading "while fiscal policy will remain restrictive": "The government is still on course to oversee a reduction in its general deficit to around 2.8% of GDP by 1997." But, there is another reference to the deficit for 1995 being larger than expected because of weak growth and higher public expenditure (particularly in the form of higher unemployment benefit payments). The 1996 budget "proposed a number of 'reinforcement' measures designed to ensure that general government finances achieve balance in 1998."

2. (d): "Mr Persson's main objective is to reduce the government's debt and thereby improve credit terms for Sweden." Spreads have been coming down, suggesting that "the main goal is within his grasp." Also (g): wanting to meet criteria for being in EMU. "Economic policy is currently conducted on the basis of a convergence programme." "Chief among its objectives are to stabilise the level of central government debt in relation to GDP by 1996; to reduce the general government deficit to less than 3% of GDP in 1997; and to eliminate the general government deficit by 1998." "Still, the government has repeatedly declared that it wants Sweden to be able to meet the necessary criteria for membership as soon as possible, to permit rapid entry, should that be found to be in the national interest."
3. Much discussion of how much things have improved with regard to deficit. "Interest rates have continued to fall, and the gap with equivalent German rates has begun to narrow."
4. Banks continue to strengthen.

### **1997Q1:**

1. "A looser budgetary stance is forecast before the 1998 general election." "The fiscal position in Sweden has been greatly improved since 1996, with the central government deficit now in the region of 4% of GDP. A budget surplus is at least a prospect for 1999, but the government is considering some spending increases, and tax reductions have not been ruled out." Budget improvement due to more favorable growth (and so more tax revenue) and some one-off things. Government pledged to spend the projected surplus on raising public spending "targeted primarily at boosting employment, healthcare and other social services. However, the government did not rule out the possibility that the fiscal improvement might be used to reduce taxes." "A slightly easier fiscal policy is planned."
2. Political (c) and countercyclical (b). Government "announced a mini-package of spending measures for 1998, confirming the view that the EIU has taken in the past: that any fiscal leeway would be used to increase spending in key areas as the election approaches." See (1) above for mentions of dealing with high unemployment. "Although the government would still achieve its target of a balanced budget in 1998, the decision to use the fiscal windfall to reverse some of its earlier spending cuts caused some concern. There were worries that, with a general election in 1998 and facing criticism both from the opposition and from within its own ranks over its austere fiscal policies, the Social Democratic Party had abandoned its commitment to fiscal austerity in search of electoral gains." "There are fears that social and political pressures may yet force a return to more traditional policies of using public spending—and budget deficits—to support employment."
3. "The package worried the markets, raising fears that the Social Democrats were about to abandon fiscal austerity in the run-up to the election, while debt still needed to be reduced. This was probably an overreaction." The deficit is actually under control. "In contrast to the situation a year ago, when most analysts were predicting that Sweden would fail to meet the convergence criteria for EMU membership, ... the budget deficit will be comfortably below the 3% reference rate (and will be among the lowest in Europe); and the debt/GDP ratio, although still above 60%, is on a clear declining trend."
4. "Unemployment stands at around 8% of the labour force, which is well above Sweden's historical trend of near-full employment."

**Bottom Line: There was much fiscal expansion in Sweden for financial rescue early on. This expansion was partly counterbalanced by austerity on other fronts owing to a mixture of ideas (the Conservative-led government wanted to shrink the welfare state) and concern about spreads (so a form of market access). Fiscal policy then switched to net austerity. Ideas played a role after the change in government in 1994: the new government also supported getting the budget under control and the electorate seemed to support that. Later on, a desire to meet EU criteria was an important motivation for continued austerity.**

## **MEXICO (1996:1)**

### **1996Q1 (pre-crisis):**

1. "Public spending was cut by 9% in real terms in the first nine months of the year (on a year earlier); a budget surplus of 0.1% of GDP was recorded." It is a little hard to tell what is going on with the budget: "Under the terms of the APRE the government has also undertaken to maintain a balanced budget in 1996. On the one hand, it plans to reduce its current spending by 4.75% in real terms in 1996, and, on the other, it is raising the prices of publicly provided goods and services."
2.
  - Financial rescue (a): "nervousness about the health of the banking system. The piecemeal approach which the government has adopted suggests that it has been slow to appreciate just how serious the problem of non-performing loans has become. And, in fact, the latest rescue measures, which may not be the last, could well upset the budget calculations for this year."
  - Some countercyclical actions, but it is hard to see any expansion on net. So it does not appear that (b) is an important motivation.
  - (e): "A major factor in last year's economic downturn was fiscal adjustment. Committed, under the terms of its financing agreements with the IMF and the US administration, to achieving a public-sector surplus of 0.5% of GDP, the federal government reduced its overall spending by 9.6% in real terms in the first nine months of the year."
3. Discussion of external debt, but not sovereign debt-to-GDP ratio.
4. Discussion of reforming the pension system. Economy is in a severe recession.

### **1996Q3:**

1. "[O]rthodox economic policies." Austerity: "strict fiscal and monetary control." Non-interest public spending fell by 3% in Q1.
2.
  - (d): "Anxious to contain inflation and regain investors' confidence, the government has kept to tight fiscal and monetary policies .... It ... has introduced yet more measures to prop up the banking sector." "[T]he economic team's main objective is to re-establish its credibility and regain the confidence of investors. Accordingly, it will continue with its austere fiscal policy this year."
  - (a) and (d): "The cost of the banking crisis and the loss of revenue due to lower oil prices and to workers starting to opt out of the state social security system make a fiscal deficit likely." "Mindful of the damage a wholesale banking collapse would do to investors' perceptions of Mexico, the government has gone to considerable lengths to help banks deal with the problem of non-performing loans."
  - Also (e): "The government will have to keep the [budget] shortfall as small as possible in order to maintain the confidence of foreign investors and the support of the IMF, from which a new extended fund facility is to be sought."
3. Discussion of Mexico's low domestic saving ratio and the importance of capital inflows. Got a stand-by agreement from the IMF in Feb. 1995, which was recently extended. "The country's risk premium is still much higher than it was before December 1994 but it should continue to fall as long as there are no major upheavals on the political front and economic stability it consolidated." "As well as lengthening the average maturity of its debt, the government has been able to reduce financing costs through its recent forays into the international capital markets." "With the two main US rating agencies giving the issue an investment grade rating."

4. Bank bailout is expensive—\$19.8 billion. There has been a recession for the last 18 months. Also running tight monetary policy.

#### **1997Q1:**

1. “[T]he government has little room to stimulate the economy through demand management.” Government projecting a public-sector deficit of 0.5% of GDP for 1997, aimed for balance in 1996.
2. (d), (e), and (a): “Mindful of the need to retain the support of overseas lenders and investors, it is unlikely to abandon its disciplined fiscal stance in order to propel the economy forward. Given the narrow tax base and the cost of bank bail-outs, a surge in spending would endanger the fiscal equilibrium.” “Despite fears that the government will give in to the temptation to overspend in an election year, the need to maintain the markets’ confidence will constrain the size of the fiscal deficit.” There is surprisingly little mention of the IMF, but it still has an agreement and is negotiating for a three-year precautionary line of credit, so its conditionality is likely a factor.
3. Government is making payments on what it borrowed from the US and the IMF: “an important gesture to underline to the outside world that Mexico’s financial crisis has been overcome.”
4. Continuing shortage of credit. High NPLs.

#### **1997Q3:**

1. PRI resisting reduction in VAT “because of its adverse effect on the fiscal accounts.” Doing social security reform, which has substantial budget costs. Forecasting a deficit of 0.5% of GDP. “Public finances register a surplus in the first quarter.” “Spending was kept under control, despite fears of a loss of restraint in the run-up to the elections.”
2. Political developments could lead to higher spending to stimulate the economy. But even left-wing rival party “will have little to gain from presenting itself as hostile to investors.” So, the main reason appears to be (d).
3. The government “has taken advantage of buoyant international liquidity to conduct further debt refinancing operations.” Paying off debt to US.
4. Ministry of Finance “launched a new three-year development plan ... (Pronafide). Pronafide’s stated aim is to break with Mexico’s recent tradition of ending each six-year presidential term with an economic crisis and to lay the foundations for sustainable, long-term growth.”

#### **1998Q1:**

1. “VAT will remain at 15% as government policies emerge unscathed from the budget debates. But expenditure has been cut in response to falling oil prices.” (VAT had been raised during the 1995 crisis.) “Public finances remain under control.” Seeking a public deficit equivalent to 1.25% of GDP in 1998. Expenditure has been cut as a result of falling oil prices.
2. “[T]he budget presented by the government in early November remained faithful to the cautious macroeconomic programme contained in the PRONAFIDE document.” “The government opposed these demands [to cut the VAT], arguing that a reduction in the VAT rate would require social expenditure cuts, reduce internal savings, and encourage an expansion in consumption which could overheat the economy.” It sounds as though market access (d) or ideas about desirable countercyclical policy (b) are the main determinants.
3. Negotiating a contingency loan from international commercial banks (in case turbulence in world markets makes it hard to raise bond finance at reasonable rates).

4. East Asia crisis is causing some trouble for Mexico. “Although the accumulation of reserves incurs quasi-fiscal costs ..., it proved valuable during the currency speculation triggered by the financial crisis in Asia.” Overhauling the banking sector.

### 1998Q3:

1. “The government has made its third budget adjustment of 1998 in response to a persistently low price for oil.” “[T]otal cuts to this year’s budget to ... 0.92% of expected 1998 GDP.” “Public finances deteriorate, but remain in surplus.”
2. “The latest budget cut reaffirms the government’s commitment to sound public finances.” The government seems to be cutting spending because oil revenues are down. EIU just takes this as a given, so it is hard to tell if it is ideas, IMF conditionality, or market access.
3. “Public indebtedness increases slightly.” “The proportion of public debt to GDP in Mexico—among the lowest in the OECD—will experience the highest rise in history if and when Congress approves the reform to the Fobaproa ..., converting the scheme’s liabilities from ‘contingency debt’ into public debt overnight.”
4. Much talk of the need for fiscal reform because revenues depend too much on oil prices. Mexican officials are trying to figure out what to do with the Fobaproa liabilities (related to bank rescue). Government wants to convert them into public debt. Cost of rescue was 17% of 1997 GDP.

### 1999Q1:

1. “[H]arsh economic measures.” “The government’s humiliating retreat from its attempts to broaden the coverage of value-added tax.” “[G]overnment’s disciplined fiscal stance.” New target for 1999 is a non-financial public-sector deficit of 1.25% of GDP. Trimming government spending to match falling oil revenues. Very slight fiscal tightening relative to previous year.
2. “The Zedillo government, which will continue to place great emphasis on fiscal discipline.” The EIU doesn’t tell us why they have this emphasis; it appears to be some mixture of market access (d), ideas (f), and IMF conditionality (e). The desire to prevent a crisis at the end of the administration in 2000 is given as a reason; that sounds like market access and concern about the exchange rate. Interestingly, “The economic programme for 1997-2000 [Pronafide] ... was quietly dropped, its main objectives now regarded as unattainable.”
3. Fobaproa liabilities not turned into public debt; instead, new body created and will get yearly funds to service notes. Public debt is 32.1%, among lowest in OECD. If Fobaproa liabilities are included that would increase this by 17 p.p. (so close to OECD average).
4. “Mexico triggered the wrath of international commercial banks in late September 1998 by activating a credit line that had been negotiated 12 months beforehand.”

### 1999Q3:

1. Fiscal reform will be impossible. Government is not increasing public spending in aftermath of the recovery in world oil prices.
2. “An agreement has been reached with the IMF as part of a larger financial package that includes contingency financing from the US.” “The government has refused to increase public expenditure despite higher oil prices.” “[G]overnment’s disciplined fiscal stance.” (e) IMF conditionality; agree to modest deficits. “In its letter of intent to the IMF, the government stated that any extraordinary revenue from oil exports would be used primarily to reduce public debt.” Also, Zedillo wants to make sure that “the handover of power in 2000 is not accompanied by a currency and balance-of-payments crisis.” Sounds like a mixture of market access and (probably good) ideas. So, (d) and (f).

3. A 17-month IMF stand-by agreement was secured. Mexico will receive \$4.2 billion. Same boilerplate about the size of the debt as in 1999Q1 report. Bond issue got a boost from Moody's that said it was considering an upgrade.
4. Economy is expected to slow. IMF agreement was described as "financial armour." There have been crises at each political transition; the aim is to not have one this time.

#### **2000Q1:**

1. "The level of short-term debt denominated in foreign currency is low. Thanks to the oil price recovery and a firm policy stance, the government is likely to have met its target of a non-financial public sector (NFPS) deficit of 1.25% of GDP for 1999, and almost certainly will not stray from a targeted deficit equivalent to 1% of GDP during 2000."
2. "The approved budget projects a fiscal deficit for the non-financial public sector (NFPS) of 1% of GDP (compared with 1.25% of GDP in 1999), the same as the government's original proposal. This is a prudent level and is consistent with the Zedillo administration's stated goal of providing a stable macroeconomic environment during the transition to the next administration." Sounds like a mixture of market access (d) and ideas (f).
3. "Although the direction of economic policy is unlikely to change dramatically in the next administration, investors may become jittery during the transition period, particularly if the incoming administration does not clarify its economic stance in the long interval between the election (July 2nd) and the beginning of the new government (December 1st), potentially leading to capital flight." Talks about external debt, but not government debt explicitly.
4. "The government's budget proposals for 2000 had a difficult passage through Congress." First budget failed; had to be modified.

**Bottom Line: There was substantial financial rescue in Mexico, but on net fiscal policy was contractionary throughout, at times strongly so. The main motivation for the austerity was a blend of market access and IMF conditionality. Market access was a substantial problem and the government was trying to regain the confidence of investors and satisfy the IMF. There was also an element of ideas at the end of the period. The outgoing president wanted to prevent a crisis at the handover of government in 2000, and so wanted to run careful policy to prevent trouble.**

## **JAPAN (1997:2)**

### **1997Q3 (pre-crisis):**

1. “Despite fiscal tightening, the economy will grow at a real rate of 2.4% in 1998.” “Radical cuts in fiscal spending are being planned incorporating numerical targets.” “A Fiscal Reform Law, incorporating the proposals in binding numerical reduction targets, is being drawn up and will be presented to the Diet ... towards the end of the year.”
2. There is remarkably little on the reasons for the fiscal tightening. It sounds as if it is ideas (f): “The finance minister ... attempted to allay concerns about the possible deflationary impact of fiscal tightening by stressing that fiscal reform would lead to an increase in demand in the medium and longer term.” The government is doing the tightening despite concerns about short-term effects, because it might make the economy healthier in the longer run.
3. Nothing about debt in this issue.
4. “One cloud on Japan’s economic horizon is the potential failure of the country’s financial sector to sort out its problems and to benefit from the coming ‘Big Bang’ package of comprehensive financial deregulation which is due to be in place by 2001.”

### **1998Q1:**

1. “The government has stepped away from the more meaningful items on its reform agenda and is now focusing on a bail-out of the financial sector.” Fiscal tightening in April 1997. Dec. 17<sup>th</sup> stimulus plan (increase of only 0.4% over the previous year).
2. (a): Financial rescue is important (see 1 above). Also some countercyclical (b): “Public spending will rise somewhat in early 1998, as the government brings forward public-works projects in an effort to revitalise the economy, but will ultimately be constrained by the need to limit the budget deficit, which already exceeds 5% of GDP. Thus state stimulus will recede as private consumption recovers towards early 1999.” (f) and (c): The prime minister wants fiscal rectitude, but political and public pressure for stimulus. He eventually capitulates. Thus politics plays a role. But, could be an element of ideas—that is why Japan did not expand more.
3. EIU says stimulus will be constrained by the need to limit the budget deficit, but it doesn’t explain why.
4. Serious weakness of Japan’s banks. Many NPLs. EIU says stimulus package is not really as aggressive as it superficially appears. Some discussion of tight credit.

### **1998Q3:**

1. Previous prime minister is out. New one not as tied to fiscal rectitude, but has been vague about fiscal stimulus plans. Expected to be stimulatory. Mention that actual government spending has been substantially less than announced in the April 1998 stimulus package.
2. (b) and (a): “Mr Hashimoto’s cabinet hesitated to expand government spending and cut taxes because it had staked its political prestige upon fiscal restraint. This was ultimately an impossible position to hold, however .... Now that Mr Hashimoto has been replaced, such a change of direction has become much easier, for the new cabinet has never formally committed itself to balancing the budget.”
3. EIU thinks debt is a big problem. Mentions that Moody’s has put Japanese debt on “negative credit watch.” But says the government can’t deal with this problem until the economy is stronger. “Restoring Japan to fiscal health cannot, however, be safely accomplished until the economy is strong enough to absorb the strains.” VAT increase in 1997 viewed as a source of current troubles.
4. Total Plan for dealing with banking problems. Bridge banks. Banks reluctant to lend.

**1999Q1:**

1. Another stimulus package and more tax cuts were announced at the end of 1998. Seems quite large. Spending is forecast to rise by more than 5%. Public investment will grow by 11.1% in 1999, reversing the contractions of the previous two years.
2. (b): EIU seems to think it is obvious that this is being done (and needs to be done) to reflate the economy. "In keeping with pledges it made after Keizo Obuchi became prime minister at the end of July last year, in mid-November the government unveiled a new package of proposals designed to stimulate economic recovery." "[T]he sheer size indicated that the government at last recognised the depth and seriousness of Japan's economic problems."
3. EIU clearly thinks deficit and debt are big problems. Japanese bond yields rose from 0.8% to 2.1%. Seems to be domestic purchasers who are balking.
4. EIU mentions that actual spending often differs from announced level. One issue is that local governments are often assumed to participate, but are not required to. Government has authority to nationalize banks (and is beginning to do so).

**1999Q3:**

1. Vague jobs plan, EIU expecting more. "We continue to believe that the government will have little choice but to introduce a spending package in September or October 1999." Budget guidelines call for an increase of 1.5% in policy-related spending.
2. (b): "the government recently formulated a new spending package ... that would create artificial demand for labour, thereby stemming the tide of job losses and bolstering the government's political fortunes." This last statement suggests politics (c) might also play a role.
3. EIU concerned about deficit and debt; no sense that Japan is. Deficit is expected to be 9.2% of GDP and government debt 123.2% of GDP; "both will be high by the standards of other developed countries and will give cause for concern."
4. Another bank nationalized. Risk of a further collapse among Japan's largest banks has receded for the moment thanks to the recapitalization package.

**2000Q1:**

1. "Fiscal policy will remain broadly accommodating." The fourth largest item in the budget proposal is the "now notorious public works allocation, which totals ¥9.4trn, money that has in the past often been spent on wasteful projects." "[A]nother large stimulus package."
2.
  - (b) and (c): "With the possibility of a difficult lower house election and little sign of the hoped-for self-sustaining recovery in private-sector demand, the government will have little choice but to maintain a broadly accommodating fiscal policy in 2000-01. Despite the country's rapidly deteriorating public finances, we do not, therefore, expect the government to move towards fiscal rehabilitation over the forecast period, either by cutting back substantially on public works programmes or through taxation." "However, with voters becoming increasingly sceptical of the ability of fiscal stimulus packages to trigger lasting economic recovery and concerns in financial markets about the state of Japan's public finances growing, the government will be hesitant about introducing another package of public spending in 2000, or even in 2001."
  - "Yet the government insists that such spending must continue until private-sector demand growth becomes self-sustaining."
3. See 2 above for statement that markets might be getting nervous about fiscal situation. The deficit is large in substantial part because of debt servicing—mainly a very large

quantity of debt. A recent report recommends higher revenues; EIU says, "Given the size of the national debt, ... the advisability of postponing fiscal reform ... is dubious."

4. "The government has retreated on several important economic reforms."

#### **2000M6:**

1. "Fiscal policy will remain broadly accommodating, but the government will not introduce another fiscal stimulus package containing new spending." "Reform of the Fiscal Investment and Loan Programme has been watered down. The government has enacted legislation to raise the age at which people receive pensions from 2013 and to reduce the size of pension payments by 5%. Tokyo's government has introduced a tax on large banks."
2. (b): "Japan's fiscal position will worsen in 2000-01 as the broad momentum of public spending is maintained in order to support the fragile recovery in private-sector demand. There will be no sharp tightening in fiscal policy until after the forecast period. We expect the budget deficit (including social security surplus) and gross government debt to rise, reaching 9% and 125.9% of GDP in 2001 respectively."
3. "Notwithstanding the need to support private-sector demand, the government will be hesitant about introducing another traditional stimulus package (that is, dominated by public works) in 2000-01. This will reflect the increasing scepticism on the part of voters about the ability of fiscal stimulus packages to trigger lasting economic recovery and the growing concerns in financial markets about the state of Japan's finances."
4. Continued financial market restructuring.

#### **2000M12:**

1. Mild stimulus—mainly designed to prevent a decline in G. Smaller than previous.
2. (b): "A supplementary budget worth ¥4.8trn ... to fund another stimulus package was approved by parliament in mid-November." "[P]ublic spending is maintained in order to support the fragile recovery in private-sector demand." But, ideas (f) are also playing a role. "Although Mr Mori and his supporters favour further fiscal expansion and are not strong advocates of economic reform, their authority has been weakened by Mr Mori's continued deep unpopularity and by the return to mainstream LDP politics of Mr Hashimoto on a policy platform of fiscal and economic change."
3. Deficit will reach 8.4% and debt 129.4%. Same statement about growing market concerns about state of Japan's finances.
4. Much political instability, which is leading to uncertainty about economic policy. Stock market slumping.

#### **2001M6:**

1. Emergency economic package in April, but proposals lacked details. Won't be implemented until 2002.
2.
  - (f): New PM seems to think rectitude is good. "In early May Mr Koizumi set out his economic policy platform: fiscal reform by limiting government borrowing, the writing off of bad debt held by private-sector banks within 2-3 years and the privatisation of post office operations." "Although he has made much of his pledge to cap JGB issuance, which one assumes is part of a more general thrust to cut spending, no details have been provided of where such cuts may be made." Thus, ideas seem particularly important in limiting fiscal stimulus.
  - (b): "Owing to Japan's poor economic outlook, we believe that the government will have little choice but to maintain a broadly expansionary fiscal policy in 2001-02"

- despite Mr Koizumi's promises." This is certainly the EIU's view; there is no evidence that the government agrees.
3. EIU discusses that plan to privatize postal savings could cause outflow of funds from state sector and trigger run on JGBs. Could lead to a fiscal crisis. EIU says: "Japan's fiscal position will worsen over the forecast period, with the budget deficit and gross public debt reaching 7.2% and 130% of GDP respectively in 2002." "Mr Koizumi, meanwhile, declared that Japan must quickly curtail its budget deficits lest the burgeoning national debt trigger a financial crisis. This call for temperance resonated with voters and contributed to Mr Koizumi's victory."
  4. New PM, wants to cap bond issuance and privatize post office operations. So, may be moving toward some austerity. Decline in the stock market has put immense pressure on Japan's banks.

#### **2001M12:**

1. "In mid-November the Diet approved a small supplementary budget." "[O]nly days after the Diet passed the supplementary budget, Mr Koizumi stated that he would after all think about putting together a second supplementary budget for submission to the Diet in January 2002."
2.
  - (b): "With a stream of bleak economic data confirming the severity of the current economic slowdown and real GDP likely to contract in 2002, Mr Koizumi's ambitious programme of fiscal tightening in 2002/03 looks increasingly unrealistic."
  - (f): PM favors fiscal rectitude. "Mr Koizumi's apparently unbending commitment to fiscal tightening." This may explain why the government does not move more strongly toward expansionary fiscal policy.
3. Nothing in this issue.
4. Japan has slipped back into recession.

#### **2002M6:**

1. Tightening plan looks even more unrealistic. Government may fall, and in that case more expansion is possible. "The Economist Intelligence Unit's economic forecast assumes that Mr Koizumi's weakened position, combined with slow economic growth, will in effect make radical reforms of the kind promised by Mr Koizumi all but impossible in 2002-03."
2. (f) "The likelihood of a shift to a more expansionary fiscal policy over the forecast period would be increased if Mr Koizumi fell from office and was replaced by a figure from one of the LDP's conservative factions."
3. Nothing in this issue.
4. Doing a review of banks.

**Bottom Line: Japan engaged in at least modest fiscal expansion throughout the post-crisis period. Initially, it undertook some fiscal stimulus for countercyclical reasons and financial rescue (though ideas about the importance of fiscal rectitude may have limited actions). In mid-1998, a new government came in and did more aggressive stimulus and financial rescue. There was a little concern about market access that may have restrained stimulus, but it did not lead to austerity. Political considerations and countercyclical aims were the main motivations for continued fiscal expansion later in the post-crisis period.**

## **KOREA (1997:2)**

### **1997Q3 (pre-crisis):**

1. Some fiscal stimulus.
2.
  - (c): “First is the fact that the public sector will, in an election year, be a source of expansion. Since the ruling party has every wish to win the presidential elections due in December this year, it is most unlikely to take or pledge unpopular spending cuts or tax rises.” Another reference to politics, this time as a reason for not doing more financial reform.
  - (a) and (b): “The public finances are basically sound, although they face pressure, for example from the need to find the funds to prop up the tottering financial sector. Meanwhile, ongoing spending on infrastructure and other programmes will ensure some fiscal stimulus.”
3. Discussion of external indebtedness, but no discussion of government debt.
4. There is much discussion of tensions in the banking system and the “real risk of a domino effect, which to some extent South Korea is lucky to have avoided this year.”

### **1998Q1:**

1. Fiscal policy is being tightened. Short-run austerity. IMF wants offsetting measures of 1.5% of GDP to make up for the reduction in revenues due to slower growth and the interest costs of restructuring the financial sector.
2.
  - (e): “The IMF will effectively dictate economic policy in the short term.” IMF packages “commit the government to the classic combination of monetary and fiscal tightening.” Conditions include “tight fiscal policy in 1998 involving additional fiscal measures” such as tax increases and spending cuts. “The crisis has engendered the unity necessary to rally behind the need to accept IMF prescriptions despite the pain.”
  - Also, clearly an element of market access (d): “While there can be no guarantee ... that confidence has been definitively restored, the incoming government and the current government, acting together, have successfully convinced investors that they are seriously intending to carry out undertakings given to the IMF.” “[M]uch of the cost of restoring South Korea’s international creditworthiness will be borne by the taxpayer.”
3.
  - Reference to “South Korean debt mountain,” but EIU makes clear that the debt is held by private companies and banks, not the Korean government.
  - “Large financing requirements are inevitable over the next two years. Even if the terms of the current negotiation end up being more favourable to South Korea than seemed likely a month ago and the ratings agencies come up with more favourable—and more realistic—ratings for sovereign debt shortly, South Korea will be paying more for a larger stock of debt.”
  - Total debt is 69% of GDP (not sure what this is—it is too high for central government, could be all government or could be all external).
  - Reference to: “By late December South Korea was on the verge of default. On December 23<sup>rd</sup> Standard & Poor’s cut the country’s long-term foreign-currency rating to B plus, from BBB minus.” Had been AA minus in Sept. 1997.
4. “[I]nterest costs of restructuring the financial sector will amount to” about 0.8% of GDP. Very tight credit conditions. IMF package: Dec. 4, 1997.

**1998Q3:**

1. "The government wants to give a fiscal boost to the economy." Seeking IMF approval to loosen fiscal policy (but not a lot).
2. (b): motivation seems to be countercyclical. Economy is in a significant recession. "The depth of the recession affecting the domestic economy ... has prompted urgent calls for a stimulus." "Talks about this [stimulus] were taking place at the time of writing, and the IMF is likely to agree."
3. There is a section on debt profile. "[D]ebt of the public sector, now playing a key role as the conduit for the inflow of IMF-sponsored funds, has risen markedly." "South Korea's bond issue took place despite significant obstacles. For one, South Korea's debt is still rated below investment grade by the US rating agencies."
4. Continued tight credit conditions.

**1999Q1:**

1. 1999 budget has passed. More than 50% of spending will be front-loaded (is being sold as the way they are doing some fiscal stimulus). Deficit projected at 5.1% of GDP, which is a lot bigger than in early 1998.
2.
  - (b): "In its 1999 budget the government envisages increased spending on public works to alleviate unemployment."
  - (a): Financial rescue is given as another reason spending is increasing. "Fiscal policy will also remain loose over the forecast period, as the government increases spending on unemployment programmes and financial-sector restructuring."
  - (d): It sounds as though market access is part of the overriding strategy: "Partly to increase its creditworthiness on international markets ... the government made prompt repayment of \$2.8bn of supplemental reserve facility resources owed to the IMF." Not clear that it is affecting fiscal policy, but is driving its debt management.
3. No obvious discussion of debt situation.
4. Very tight credit conditions for most companies. As part of an attempt to reorganize the domestic bond market, the government is establishing its 3-year bonds as the new benchmark.

**1999Q3:**

1. "A supplementary budget worth W2.8trn (\$2.4bn) was passed by the National Assembly in April, the main purpose of which was to reduce unemployment." It included infrastructure spending and short-term job creation programmes. "Although mindful of the need to use fiscal policy to support economic growth, the government may start to slow spending increases in 2000 in order to achieve its stated medium-term target of balancing the budget by 2006." So tighter fiscal policy may be coming.
2.
  - (b) countercyclical; to reduce unemployment (see 1 above). "Public investment ... will run at relatively high levels in both 1999 and 2000, as the government seeks to support the recovery in private-sector demand."
  - Perhaps also (c): "Also with an eye on the parliamentary election next year, the government has proposed a further stimulus package of tax cuts and subsidies."
  - Some (a): "It is, however, unlikely to be able to cut outlays for financial sector restructuring in the short term. This is because the cost to the government of reforming the financial sector is likely to rise further over the forecast period, particularly if it has to inject more funds into financial institutions it wants sold to foreigners."

3. Nothing on debt or concern.
4. Banks are doing better, but cost of clean-up is rising.

### **2000Q1:**

1. Continued expansionary policy. Rapid growth is raising revenue, which may allow more spending.
2. (b) and (c): “Political considerations ahead of the April National Assembly election are driving economic policy formation.” “With a parliamentary election imminent, the focus is on sustaining growth without fuelling inflation.”
3. MOFE estimates that central government debt stood at 18.7% of GDP at end-1999, down from previously forecast of 19.4%. EIU sounds quite positive: “Public finances are improving.” Spread of government 10-yr global bonds over comparable US treasuries had tightened to 140-160 basis points, down from 260-280 in July and August of 1999. Reflects upgrades of sovereign ratings at end-1999 by two US rating agencies.
4. W76.7trn has been spent on restructuring the domestic financial sector. “At the end of December last year the IMF announced South Korea’s graduation from its tutelage.”

### **2000M8:**

1. “The government unveiled a supplementary budget worth W2.4trn (US\$2.2bn) in July.” “The focus of fiscal policy in 2000-01 will be on sustaining economic growth without stoking inflationary pressures. ... [I]t will attempt to lower aggregate demand by slowing the pace of spending increases.” Fiscal policy appears to be roughly neutral.
2. No motivation is needed because fiscal policy is basically neutral. Economy is strong. “To this end too, notwithstanding the government’s commitment to return its finances to balance as soon as possible, in July the first supplementary budget for 2000 was unveiled. According to the government, the aim of extra spending is to combat ‘microeconomic sectoral weaknesses’ in order to ensure the economy can achieve a sustainable growth trajectory in the future. The government stressed, however, that, owing to concerns about overheating, the purpose of the budget was not to provide a macroeconomic stimulus to the economy.”
3. “South Korea’s public finances are sound compared with many other OECD countries. However, the rapid ageing of the population and the potential costs of having to absorb North Korea at some stage in the future put a premium on improving the fiscal position sooner rather than later.” Budget deficit equivalent to 2.8% of GDP.
4. Government announced plans to relinquish its stake in the banking sector.

### **2001M2:**

1. Expected deficit of 0.1% of GDP in 2001. Bond issue will be cut sharply, partly reflecting bullish tax revenue growth. “Overall, however, the budget remains expansionary and is likely, in light of the imminent slowdown and the healthy state of the public finances to be revised and supplemented.”
2. It is not clear that any motivation is needed—fiscal policy is basically neutral. It sounds like there might be a little pressure both ways—some expansion because growth is slowing, but longer-run contraction to deal with aging of the population.
3. Some statement about South Korea’s public finances being strong. Balanced budget to be achieved by 2003.
4. Economic growth is slowing.

### **2001M8:**

1. “The cabinet approved a supplementary budget worth W5.1trn (US\$3.9bn) in mid-June. W3.6trn of the funds in the budget will be disbursed to local governments in order to

- boost regional economic growth. The budget will mainly be funded from the 2000 budget surplus.”
2. EIU thinks that “public spending will remain at relatively high levels both in order to support domestic demand and to shore up support for the government in the run-up to the end-2002 presidential election.” Opposition party says the same thing. So, countercyclical (b) and politics (c) could both be playing a role.
  3. “South Korea’s public finances are sound compared with those of many other OECD countries. Gross government debt stands at around 10% of GDP, while on a net basis South Korea is one of only three countries in the OECD (the others are Norway and Finland) whose public finances are in the black (that is, assets exceed liabilities). However, the rapid ageing of the population, the potential costs of having to absorb North Korea at some stage in the future and the still uncertain cost of restructuring the financial sector put a premium on improving the fiscal position sooner rather than later. With this in mind, the government’s own medium-term fiscal forecast projects that a balanced budget will be achieved by 2003.”
  4. Economic growth is slowing.

**Bottom Line: Korea initially engaged in some fiscal contraction due to IMF conditionality and problems with market access. Pretty quickly there was a move toward modest fiscal expansion driven by countercyclical aims, financial rescue, and political considerations. Eventually the government shifted to roughly neutral fiscal policy as the economy recovered.**

## **TURKEY (2001:1)**

### **2001M1 (pre-crisis):**

1. “The 2001 budget approved in December set tight targets.” “The public accounts is the area in which Turkey has made most progress. The overall consolidated central government deficit, which is now estimated at just over 10% of GDP in 2000, is forecast to decline sharply to 4.8% in 2001, owing to the rapid fall in yields on government securities in 2000. It will edge up again to 5.5% in 2002, as we expect interest rates to remain higher in 2001 than forecast before the financial turmoil last November-December, which will push up interest payments next year. Offsetting this, however will be additional budgetary measures, notably higher taxes, more rapid privatisation, a tighter incomes policy and expenditure cuts—needed to dampen domestic demand.” Long discussion of fiscal austerity measures.
2.
  - (e): “IMF-backed three-year stabilisation programme launched at the beginning of 2000. Tighter fiscal policy and a continuation of the crawling-peg exchange-rate regime.” “Turkey’s ambitious IMF-backed US\$4bn three-year stabilisation programme, launched in December 1999, relies on three main areas of policy adjustment: a rapid reduction of the fiscal deficit; structural reform, especially privatisation; and a rigid crawling-peg exchange-rate regime in the early years of adjustment, supported by a forward-looking incomes policy.”
  - (d): “The 2001 budget was passed in December. It was tighter than previously expected in order to dampen domestic demand and restore investor confidence. Although some slippage is forecast ..., we still expect the government to make enough progress to retain the support of the IMF.”
  - Prelude to (g): Just starting the process of accession to the EU; not yet affecting fiscal policy. “At the beginning of December 2000 Turkey and the EU reached agreement on the Accession Partnership Document, outlining the measures which Turkey is required to take if it is to open full accession negotiations with the EU and eventually gain membership. Turkey is expected to issue a National Programme for implementing these proposals. On January 4th 2001 it was reported that a draft of this had been prepared, although it was not expected to be ratified by parliament and presented to the EU Commission until the end of January.”
3. “The domestic debt is estimated to have increased by less than 50% in 2000, compared to almost 100% in 1999. The tight fiscal policies foreseen for 2001 should further stem the growth of the debt in real as well as nominal terms. However, higher interest rates in the wake of the financial crisis at the end of 2000 will raise the cost of servicing Turkey’s floating-rate domestic borrowing—now comprising nearly 20% of the domestic debt—in 2001.”
4. “Increased IMF backing followed financial turmoil at the end of 2000.” “Even so, financial market confidence collapsed in late November, partly owing to difficulties in the banking sector, triggering capital outflows of almost US\$7bn in little over a week. In early December, to stem the exodus of funds, the IMF agreed to provide US\$7.5bn in the form of a Supplemental Reserve Facility—in addition to almost US\$3bn still to be disbursed under the existing stand-by credit facility.” Large decline in stock prices.

### **2001M7:**

1. “Domestic debt soared in the five months to May because of bank rescues.” “Despite the adoption of sweeping new policies, the authorities will have grave difficulty curbing the rise in the fiscal deficit in 2001 and placing it on a downward path in 2002.” Deficit will rise from 10% in 2000 to 17% in 2001, before declining to 15.5% in 2002. Government

bail-out of the state-owned banks and takeover of the private sector banks is part of the cause of a large increase in debt. "The authorities have set ambitious targets for the consolidated public-sector primary surplus" (6.5% in 2002).

2.
  - "The main features of the new programme are structural reforms, including bank restructuring, fiscal restraint ...." "As a step towards achieving these targets, which must be met to ensure continued IMF funding, the government pushed through supplementary budget measures in mid-June to offset some slippage." "On May 15<sup>th</sup> the IMF agreed to resume its lending to Turkey and to augment the existing stand-by package by about US\$8bn." "Keeping fiscal policy tight remains one of the cornerstones of the new IMF programme." Market access (d) and IMF conditionality (e) are complementary reasons for some austerity.
  - Financial rescue (a) is going in the other direction. "In addition, the stock of public debt had risen to TL84,546trn (US\$70bn) by end-May, ... mainly as a result of the government bail-out of the state-owned banks and takeover of the private-sector banks."
3. "[S]tubbornly high yields on government securities." There is an IMF stabilization program in place. First program was aimed at stabilizing the lira; a revised (larger) program was put in place after the collapse of the rigid crawling-peg exchange rate regime. "Investors have been demanding high real yields and are unwilling to lend large amounts to the government at longer maturities." EIU is afraid that Turkey might default or restructure its debt.
4. Crisis was in November 2000 and February 2001. "[T]here is a strong risk that a political crisis could trigger the collapse of the government."

### **2002M1:**

1. "The government looks set to hit its 5.5% of GNP primary budget surplus." Government is taking many contractionary fiscal measures. "A fiscal package was announced in mid-November, and the government has started to detail and implement the revenue-raising and expenditure-cutting measures envisaged." Package of austerity measures intended to achieve its ambitious fiscal targets (also set out in the November letter of intent to the IMF). At the same time, the actual deficit "will rise from about 14.5% in 2000 to over 20% in 2001-02."
2. IMF conditionality (e) and market access (d) again seem to go together.
  - "The government remains committed to the IMF programme." "Keeping fiscal policy tight to stabilise the level of government debt remains one of the cornerstones of the IMF-backed programme."
  - "At the same time, however, the whole relationship between Turkey and the IMF was having to be reviewed in view of the difficulties in restoring financial market confidence."
  - Perhaps a small amount of politics (c): "Despite the recession and calls from backbenchers and other pressure groups to loosen fiscal policy, the government left unchanged the key target of 6.5% of GNP for the primary fiscal surplus in 2002." Could be a factor lessening the austerity.
3. "Although forecast to decline, the fiscal deficit will remain worryingly high." "With the risk of domestic debt default looming, the IMF announced in mid-November ... that it would provide Turkey with additional financial aid." "IMF approval for the new stand-by accord is understood to depend on a number of preconditions ... [including] the implementation of recently announced fiscal austerity measures." Borrowing costs are very high. Yields on government debt fluctuating from 92.5% to 71%.

4. Reform of the banking sector is another cornerstone of the IMF-backed stabilization program.

#### **2002M7:**

1. “The IMF approved the release of US\$1.15bn in June and commended the Turkish authorities for their strong policy performance. Turkey’s fiscal performance was better in 2001 than expected under the IMF stand-by agreement.” “The government’s fiscal targets for the next three years are extremely ambitious.” Primary surplus of 6.5% of GDP each year in 2002-04. High borrowing costs will keep the actual deficit large.
2.
  - May be some role for politics (c): “The IMF-backed economic reform and stabilisation programme had made steady progress until the government crisis erupted in early July. But the financial markets are now concerned that the government’s commitment to targets may have waned. Turkey faces a heavy debt repayment schedule in the second half of 2002, and two tranches of IMF credit worth a total of almost US\$4bn are scheduled for approval following reviews of Turkey’s economic performance.” Similarly, “In the three months before the election the government may be reluctant to carry out some IMF-prescribed policies, such as trimming the number of public-sector workers. The next government could also be reluctant to toe the IMF line.”
  - Market access (d) and IMF conditionality (e) are important reasons. There was a June 2002 Letter of Intent that had ambitious fiscal targets. “But the government has set itself ambitious fiscal targets for the 2002-04 period covered by the stand-by agreement.” “The eruption of the government crisis in early July has created considerable uncertainty about whether Turkey will be able to do enough to secure the credit tranches due to be released after the July and October (3<sup>rd</sup> and 4<sup>th</sup>) reviews.”
3. Government’s borrowing costs rose in May and June due to rising rates. EIU attributes it to concerns about the stability of the coalition government.
4. A new stand-by agreement was approved in Feb. 2002. It “helped to restore a degree of financial stability and avert a potential domestic debt crisis.” Another reference to government crisis that erupted in July. Crisis seems to be a political one—a government fell and there will be an early election in November.

#### **2003M1:**

1. New government insists it is committed to achieving the 6.5% of GDP target for the primary surplus agreed with the IMF under the previous government. Actual numbers look on target. Temporary budget had same targets as in original LOI. “The adoption of these targets suggested that the government had abandoned any idea of trying to negotiate with the IMF for a lower primary fiscal surplus.” Government lowered some taxes which made IMF nervous.
2.
  - Conditionality still seems to be important (e). “[T]he new AKP government, which has since its election repeatedly stated its commitment to maintaining the US\$17bn three-year stand-by accord signed in February 2002. At the same time, however, the AKP would like to loosen fiscal policy, in the long term at least.” “At the same time, however, there appears to be an awareness at government level that large primary surpluses must be generated if Turkey is to maintain IMF support and reduce its debt burden.” This makes it sound as though IMF conditionality is binding. The debt burden comment seems to have to do with the financing costs: “In view of the high

- level and cost of government debt, primary surpluses will not be sufficient to prevent high overall fiscal deficits." So, fundamentally, it is about market access.
- There could be an element of ideas (f) and politics (c), but these are clearly secondary to IMF conditionality: "The government also needs to deliver on its promise to reduce unemployment and improve living standards if it is to maintain public support. ... But it needs to do this without disrupting the IMF-backed stabilisation programme, as this would seriously damage market confidence." "At the same time, however, the new ruling party regards the social, agricultural and industrial policies followed under the IMF stand-by accords since the end of 1999 as inadequate and wants to place a stronger emphasis on accelerating growth and creating jobs."
3. Sharp reduction in government bond rates when new single-party government was elected. "Although a domestic debt crisis is still possible in the short term, the fact that at the end of November public-sector institutions held 54% of total domestic government debt reduces this risk." Government is able to borrow at least somewhat from international markets.

### **2003M7:**

1. "A tighter 2003 budget than initially expected [and other things] ... should be enough for Turkey to avoid a crisis this year. But because of the sheer size of Turkey's government debt (about 85% of GDP at end-2002), the widening current-account deficit and Turkey's vulnerability to sudden shifts of investor sentiment, the risk of a financial crisis will remain high during the outlook period." Government is still aiming at a substantial primary surplus. New LOI has same fiscal target as before.
2. Conditionality appears important; government would rather do other things. Market access may also play a role. Borrowing costs rise when the government shows lack of enthusiasm for IMF conditions. So, (d) and (e).
  - "Any signs of hesitation in the government's commitment to the IMF-backed reform programme or increased domestic political tensions are likely to erode investor confidence, making it more difficult for the government to roll over its domestic debt, most of which is short-term."
  - "[T]he government must keep fiscal policy tight if it is to be able to restore confidence in its ability to carry out the IMF-backed programme and start to reduce Turkey's large government debt."
3. "The IMF resumed lending to Turkey in mid-April, but the AKP government has been inconsistent in its commitment to IMF policies. Budget figures for the first five months of the year appeared to be on track." "The decline in yields from April onwards reflected improving confidence in the economy following the end of the Iraq war and a resumption of IMF lending." EIU expects government to start having trouble rolling over debt in early 2004. They think another crisis is likely.
4. Mainly borrowing from the domestic market. Bond yields over 60% in March, but then fell to around 48% in June.

### **2004M1:**

1. "The government took positive steps to put the economic stabilisation programme back on track in the middle of 2003, following a series of delays and slippages on IMF-agreed targets and reforms in the second quarter of the year." Government has had to introduce a number of supplementary measures to keep the primary surplus on target.
2.
  - IMF conditionality (e) continues to be central. EIU thinks that without external support for fiscal retrenchment, such retrenchment would become politically unacceptable. "Fiscal policy, including the draft budget for 2004, has been negotiated

with the IMF.” “Fund support remains essential for financial market confidence and the smooth management of the government debt.”

- There is also some continuing bank bailout (a). “An element of uncertainty exists regarding the cost of the Imar Bank bail-out, which is estimated to be around US\$6bn over the next three years.”
- 3. “The risk of a debt default has receded, at least in the short to medium term, thanks to an IMF agreement postponing some repayments scheduled for 2004-05” and increased US loans. Size of government debt: 75% of GDP. “Fund support remains essential for financial market confidence and the smooth management of the government debt.”
- 4. Interest payments are still very large, but rates are falling some. Bond yields are down in the 30% range.

#### **2004M7:**

1. “Fiscal policy remained tight in the early months of 2004.”
2. “Until recently, the government seemed reluctant to commit itself to an arrangement that would limit its room for manoeuvre, particularly in the area of fiscal policy. ... Since the May bout of volatility, there have been some signs of a greater awareness within the government that continued external support is necessary to ensure financial stability over the medium term.” This suggests that IMF conditionality (e) and market access (d) continue to be important. “In early May the prime minister revealed his government’s weariness with the level of fiscal discipline being prescribed by the IMF when he stated publicly that he would seek a reduction of the public-sector primary surplus target. However, as markets reacted nervously, Mr Erdogan and other members of his government appeared to backtrack, quickly reiterating their commitment to tight fiscal policy.”
3. Reforms under the IMF stand-by agreement have helped to restore investor confidence. Mentions government debt to GDP is around 80%. Government revealed its weariness with fiscal discipline prescribed by the IMF by saying it wanted a lower primary surplus, and markets reacted nervously. Rates rose.
4. Another IMF program may be in the works (the current one expires in Feb. 2005). A bout of financial instability in May.

#### **2005M1:**

1. Government has committed itself to maintaining a high primary fiscal surplus (6.5% of GNP) in 2005.”
2.
  - IMF conditionality remains important (e): “Of greater importance from the point of view of maintaining the current policy of fiscal discipline, we believe, will be the new IMF stand-by agreement.” “The government must keep fiscal policy tight for several years to come if it is to maintain investor confidence and reduce Turkey’s large public debt burden (an estimated 75% of GDP at end-2004) to a more sustainable level. Under a new IMF-backed programme the government will have to agree to maintain ambitious fiscal targets.”
  - EU accession conditionality is also important (g): “This programme had already been set out in the three-year Pre-Accession Economic Programme (PEP) drawn up for the EU on November 30<sup>th</sup>.” “Turkey’s bid to gain eventual accession to the EU is likely to remain the dominant focus of the government’s foreign policy during the outlook period.”
  - “A government debt crisis is not part of our central forecast, but cannot be ruled out completely in the medium term, given Turkey’s large government debt, high overall

- fiscal deficit, still relatively high real interest rates, and large debt repayments.” So, perhaps a bit of market access (d).
3. “The wide-ranging economic reforms introduced under Turkey’s IMF stand-by agreement have helped to restore investor confidence since the 2001 financial crisis.” EIU says that gross central government debt has continued to increase, reflecting the still large budget deficit. Interest payments are very large. Government was able to borrow from international bond markets.
  4. “The outline of the new three-year IMF standby agreement was announced in mid-December.”

**Bottom Line: Turkey engaged in substantial financial rescue, especially early on. But, this was followed by strong austerity. It is hard to separate market access and IMF conditionality as the motivation for the austerity. Lack of market access led to the IMF program; once in place, the IMF conditionality was strictly enforced (both by the IMF and by markets). At times politics and ideas led policymakers to suggest less austerity. Later in the analysis period, Turkey’s desire to join the EU was also a driving force for fiscal contraction.**

## **UNITED STATES (2007:2)**

### **2007M6 (pre-crisis)** (the July 2007 report is quite short):

1. A tiny bit expansionary (discussion of a bill passed in May with tax cuts of less than 0.1% of GDP).
2. Perhaps (f) and (c) (but not important).
3. General concern (among policymakers, not just EIU) about the long-term fiscal outlook. “Mr Bush has become more serious about deficit reduction and the Democrats are also committed to fiscal discipline.” But nothing concrete is happening.
4. Housing market and economy are weakening.

### **2008M1:**

1. It isn't clear that anything is actually being done. To the extent that anything is, it's expansionary. EIU says, “some fiscal measures to contain the downturn, and potentially measures to bolster the housing market, will weigh on public finances,” but the context suggests that this may be prospective rather than actual. Elsewhere, they say, “little progress will be made on economic policy until the elections. The focus will be on measures to dampen the downturn in the housing market, where some moderate reforms (leading to significant fiscal exposure to the housing market) are likely to be passed.” The only concrete measure the EIU describes is, “The tidal wave of home foreclosures expected for 2008 has prompted the administration to broker a deal with lenders for a five-year freeze on interest rates on some sub-prime mortgages,” which isn't conventional fiscal policy. In the other direction, EIU says, “more progress will be made on containing expenditure growth,” but they don't cite anything that has actually been done (despite the “more”). In short, to a first approximation nothing is happening.
2. (b) (to the extent any action is being taken)—see the mentions above of “to contain the downturn” and “to dampen the downturn in the housing market.”
3. There is general concern (among policymakers, not just EIU) about the long-term fiscal outlook. For example, “Mr Bush has become more serious about deficit reduction and the Democrats are also committed to fiscal discipline, having recently adopted pay-as-you-go rules, under which tax cuts and all new spending have to be offset by changes elsewhere in the budget.”
4. “[F]inancial crunch.”

### **2008M7:**

1. Expansionary.
2. (b). “[F]iscal measures ... to contain the downturn .... Worth around US\$150bn (just over 1% of GDP), the bulk of the package will centre on tax credits and rebates targeted at low- and middle-income families and individuals.”
3. One allusion to long-term issues: “little progress will be made on structural economic policy until after the ... elections.”
4. Economy is weakening, housing sector is in crisis, banks are fragile.

### **2009M1:**

1. Highly expansionary.
2. (a) and (b).
  - (a) and (b): “The main focus of the outgoing as well as the incoming administration will be on containing the financial crisis and the economic downturn.”
  - (a): “Financial sector stabilisation remains the focus of policy”; “the US\$750bn approved in early October, to support the financial system.”
  - (b): “Mr Obama has already made it clear that he will do everything to contain the

crisis and that he is backing another fiscal stimulus package. He will also seek to offer a government-guaranteed programme to help homeowners renegotiate their mortgages, and will offer other forms of tax relief”; “With the economic outlook deteriorating, Mr Obama is preparing a massive stimulus package. Although he has not specified the amount, press reports that his team has not denied suggest it could amount to as much as US\$500bn-700bn over two years (implying annual spending of 1.7-2.3% of GDP).”

3. There is concern about long-run fiscal outlook. (Most of the statements don't say they it's policymakers who are concerned. The closest they come is, “The very strong fiscal stimulus has raised concerns about fiscal sustainability.”)
4. “[F]inancial crisis.”

#### **2009M7:**

1. Expansionary (though the only new action described other than the actual passage of the Recovery Act, which happened just after the last report, is cash for clunkers).
2. (a) and (b). “The main focus of the administration over the forecast period will be on containing the financial and economic crisis”: “A new fiscal stimulus package, approved in February.”
3. There is a ton of stuff about concern about the deficit and debt. The EIU's tone is that this is widely shared rather than just their view; however, one gets the sense that the EIU feels strongly about the issue. Discuss level of debt and its projected increase; say, “there is now a high chance that the major rating agencies will downgrade long-term sovereign debt, currently holding a AAA rating”; “a growing focus on the sharp deterioration in the US's fiscal position has also been behind the increase” in long-term interest rates: “Misgivings centre on the huge budget deficit and on [other things]”; etc. Importantly, there's no sense that any of this is affecting policy (but EIU expects that “[c]oncerns about the fiscal position will increasingly dominate the policy discussion”). If it were affecting policy, would be a mix of (f) and (d).
4. Economy may be turning the corner.

#### **2010M1:**

1. No new actions. (Current stance is expansionary, but stimulus will be falling.)
2. (b) for past actions.
3. A fair amount about concern about deficit and debt. Talk about debt/GDP and its projected increase. Say, “the rise in federal debt ... to nearly 80% of GDP in 2014 is ... a serious concern. This raises the possibility that the major ratings agencies will downgrade long-term sovereign debt, which currently holds an AAA rating.” But EIU does not describe any impact on policy yet.
4.
  - Discussion of more stimulus, but no description of anything nontrivial that has passed.
  - EIU expects a shift toward fiscal consolidation, but nothing has happened yet.
  - Health care reform appears close to passing, but EIU doesn't describe it as clearly expansionary or contractionary.

#### **2010M7:**

1. No new actions. (Closest is: “the administration's decision to trim the budgets of most government agencies by 5%. But the current mood falls short of fiscal restraint or discipline.” Various possible actions in the works, in both directions—Bowles-Simpson and long-run fiscal consolidation, and possible \$150 billion of new stimulus.)
2. A sense that (f), and some (d), are constraints that are preventing further stimulus.

“Concerns are mounting in the US about the sustainability of the public finances. This will constrain the government’s ability to adopt further large fiscal stimulus measures even if growth softens in the coming months.”

3. There is a lot of concern about deficit, debt, and long-run fiscal trajectory. For example, “Some nervousness has begun to be felt in Washington over the trillions of dollars in monetary and fiscal stimulus that have been pumped into the economy over the past two years. Ben Bernanke, the chairman of the Federal Reserve (Fed, the central bank), warned Congress on June 9th that the federal budget, now running at a record deficit, ‘appears to be on an unsustainable path’. ... The debt crisis in Greece and other south European countries has contributed to a concentration of minds in Washington on the US’s parlous fiscal situation.” Talk about debt/GDP and its projected increase. Say that the projected rise “raises the risk of a rise in US bond yields that would raise borrowing costs and damage the recovery.”
4. Say that Greece has increased concerns about the U.S. fiscal situation.

### **2011M1:**

1. Expansionary.
2. (b). “The Obama administration has agreed with Republicans in Congress to roll out a fresh round of fiscal stimulus measures, worth around US\$300bn .... [T]he government focuses on supporting a recovery from the financial and economic crisis and averting the risk of a double-dip recession”; “Mr Obama agreed to extend the tax cuts for all income groups, backtracking on an election promise to let them expire for the richest households. In return Republicans agreed to an extension of unemployment benefits, a cut in payroll taxes for employees and a measure that allows businesses to write off investments faster in 2011.”
3. A fair amount of concern about deficit, debt, and long-run fiscal trajectory. Talk about debt/GDP and its projected increase. Say, “This creates the risk of an eventual rise in US bond yields that would raise borrowing costs and curb growth prospects. But the government faces no funding pressures at present.” (Later, they say that the increased borrowing from the new stimulus may have contributed to higher interest rates, though they don’t think that’s the main thing going on.) But no impact on policy, other than a wage freeze for federal workers, which EIU describes as a “modest” measure. “Austerity has ... been placed on the back burner.” EIU expects “spending restraint” going forward. And after a paragraph that’s about debt/GDP, say, “Concerns about US fiscal sustainability will lead to efforts to tackle long-term fiscal pressures stemming from an ageing population” (but don’t say that it’s affecting current policy).
4.
  - Bowles-Simpson has reported.
  - Over the past few issues, they have revised down their estimate of where debt/GDP is heading in the near term from about 100% to about 65%. (Not important; just seemed interesting.)

### **2011M7:**

1. Contractionary. “The Republicans forced cuts in the budget for fiscal year 2010/11 ... in early April,” and EIU sees a more general pivot to austerity. “Fiscal policy is ... starting to drag on the economy.” But actions so far seem small.
2. (f) (with one idea being that market access could become an issue in the future). “US public debt has risen sharply in recent years .... Although there is no immediate pressure on the government’s finances, Washington appears set on tackling the deficit aggressively”; “debate in Congress is now firmly focused on how to reduce the deficit”; “The government faces no funding pressures at present .... However, ... [h]igh debt levels

create the risk of an eventual rise in US bond yields that would increase borrowing costs.”

3. Some concern about deficit, debt, and long-run fiscal trajectory. Talk about debt/GDP and its projected increase. “The government faces no funding pressures at present .... However, federal debt (net of debt holdings by government agencies) is forecast to rise from just under 38% of GDP in 2008 to around 72% of GDP in 2013. High debt levels create the risk of an eventual rise in US bond yields that would increase borrowing costs and curb growth prospects.”
4. Fight over the debt ceiling is going on.

**Bottom Line: Fiscal policy in the U.S. was initially highly expansionary for countercyclical purposes and financial rescue. It then leveled out and finally turned slightly contractionary. Policymakers’ ideas about the harms of the debt and deficits in their own right, plus some concerns about market access (specifically, long-term interest rates and bond ratings), limited the expansionary actions and prompted the ultimate move to contraction.**

## **ICELAND (2008:1)**

### **2008M1 (pre-crisis):**

1. “The fiscal stance will remain expansionary, while interest rates are unlikely to fall before late 2008.” “The government surplus has been falling.” “Boosted by soaring tax receipts as a result of the rapid economic expansion in recent years, the general government finances achieved a record surplus of 7% of GDP in 2006. Income tax cuts at the beginning of 2007, a reduction in the rate of value-added tax (VAT) on food items and weaker economic activity depressed growth in government receipts in 2007 (albeit to a lesser extent than previously expected), while expenditure rose, particularly on infrastructure investment. The general government surplus is estimated to have narrowed to around 3.4% of GDP. The fiscal stance will remain expansionary in 2008-09, with the prospect of further tax cuts and increased spending.”
2. Tax revenues are rising because of rapid economic growth. Running expansionary policy (such as reducing taxes and increasing infrastructure spending). EIU does not say why directly, but it sounds procyclical.
3. “In 2009 the government finances are expected to fall slightly into deficit. The public debt/GDP ratio will remain among the lowest in the OECD.”
4. Central bank is being hawkish. Krona is very volatile.

### **2008M7:**

1. Overall, expansionary.
  - “A sharp economic slowdown is likely to result in a government budget surplus of 5.2% of GDP in 2007 moving into deficit by 2009.”
  - As the previous bullet suggests, the budget had been in surplus in recent years. “Boosted by soaring tax receipts as a result of the rapid economic expansion in recent years, the general government finances achieved a record surplus of 6.3% of GDP in 2006.” The government had cut some taxes in 2007.
  - “The fiscal stance will remain expansionary in 2008-09, with further tax cuts and increased spending (the latter partly reflecting a new package of measures aimed at offsetting the negative economic impact on communities of a reduction in fishing quotas).”
  - Government balance down to 2% of GDP in 2008, likely negative in 2009.
2.
  - (i) Procyclical: It is not crystal clear, but there is much discussion of revenues growing rapidly in recent years and there being tax cuts and infrastructure spending. This suggests that the two are linked.
  - Also (i): Reference to spending to help communities hurt by new fishing quotas (see 1 above). Pretty idiosyncratic.
3. “The public debt/GDP ratio will, however, remain among the lowest in the OECD.” “One of the main worries expressed by international investors and credit rating agencies has been the ability of the Central Bank to serve as a lender of last resort to Icelandic banks in foreign currencies, as most of their liabilities are now in currencies other than the krona and their total balance sheets now amount to 900% of GDP.”
4. Krona lost 24% in 2008Q1, “as turbulence in international financial markets led to a reappraisal of investors’ risk premiums.”

### **2009M1**

1. Overall, expansionary.
  - “Economic policy will continue to follow the IMF programme approved on November 19<sup>th</sup> 2008, but there could be tensions with the IMF. Bank restructuring will increase

- government debt from 29% of GDP at the end of 2007 to over 100%. The budget balance will swing from a surplus in 2008 to a large deficit in 2009, which the Economist Intelligence Unit forecasts will narrow only moderately in 2010. The economy is likely to contract by 12% of GDP in 2009 with domestic demand falling by 16%, and to recover only marginally in 2010.”
- “A revised budget for 2009, with cuts in expenditure and a 1-percentage-point increase in income tax was presented in mid-December.”
- 2.
- “The collapse of 85% of the country’s banking system, a system that was around ten times the size of the economy, and the consequent sharp depreciation of the Icelandic krona left the government with few viable options other than to seek assistance from the IMF [and] the country’s Nordic neighbours in late October 2008.” “Policy will be driven by the programme agreed with the IMF last November 19<sup>th</sup>.” So fiscal policy is being driven by the usual mix of lack of market access and IMF conditionality ((d) and (e)). But, “fiscal restructuring, which will proceed more slowly than the first two elements, although the government has made a start with its revised budget for 2009.” First two elements are currency stabilization and bank restructuring. The EIU says that “[t]he coalition’s previous plans for a combination of tax cuts, market liberalization, increased spending ... will have to be reassessed.” This suggests that the fiscal conditionality is somewhat binding.
  - Main source of the fiscal expansion is financial rescue (a). “The expected substantial deficit in the next two years will reflect sharply falling revenue as a result of weak domestic demand, lower profits and lower earnings, together with increased public expenditure on unemployment benefits ... and on debt interest payments (gross government debt is forecast by the IMF to increase from 29% at the end of 2007 to 109% of GDP in 2009, as a result of meeting the obligations of the former three main Icelandic banks now taken into public ownership and the injection of new funds to recapitalise them)].”
  - “The 2009 central government budget ... provides for substantial expenditure cuts ..., as well as an increase of 1 percentage point in personal income tax. These cuts will make the recession ... even worse, but are considered necessary by the government. There will still be a deficit forecast ... at just over 10% of GDP, which the IMF has accepted, deeming further expenditure cuts as likely to cause damage to the economy. However, the IMF will be expecting further fiscal measures to start closing the deficit from 2010.” The EIU does not say why the government feels some cut is necessary. But there is a pretty clear sense that the high level of debt is one reason. The sentence before the one about the 2009 budget includes, “gross government debt is forecast by the IMF to increase from 29% at the end of 2007 to 109% of GDP in 2009.”
  - “According to the IMF plan, ... deep cuts in government spending are to be postponed until 2010 because of the severe economic downturn expected in 2009. Nonetheless, the Ministry of Finance has requested that all ministries present plans for a 10% cut in spending from the budget proposal presented to parliament in October 2008.” Could suggest an element of choice and ideas (f).
3. Long discussion of the huge increase in Iceland’s debt (from a very low level). Also: “The second part of the IMF programme relates to fiscal policy in light of the increased debt burden that resulted from the restructuring of the banking system [and other factors].” EIU says “nevertheless, there will [be] a large debt servicing burden on the central government that will have to be met by extensive cuts in government spending or through higher taxes.”

4. Dramatic collapse in confidence in both Icelandic banks and currency. Severe credit conditions. Collapse of 85% of the country's banking system, a system that was around 10 times the size of the economy. IMF program also includes funding from Nordic countries.

#### **2009M7:**

1.
  - "The government has, however, taken action to comply with IMF requirements to rein in the budget deficit. The public debt is likely to exceed 100% of GDP at the end of 2009 compared with 28% two years earlier."
  - "According to the IMF plan, the government needs to bring the general government deficit from an expected 13% of GDP in 2009 to a surplus by 2013."
  - EIU says some fiscal contraction, such as further measures equivalent to 1.6% of GDP for the second half of 2009 and additional measures worth 4.3% in 2010. But details have not yet been agreed upon. At the same time, the actual deficit is very large (13% of GDP).
2.
  - "Despite the fact that there has since been a change of government, policy will be driven by the programme agreed with the IMF." So, bailout conditionality (e) seems central.
  - Nordic countries, which are also helping with bailout, are "pushing the Icelandic government hard to make early corrections to the government finances." This suggests another type of conditionality (but it is still not a choice from Iceland's perspective). The IMF seems to need or want its program to be enhanced by loans from the Nordics. (So, more (e).)
3. "A massive deterioration in the public finances is taking place in 2009": deficit will reach 13%, compared to surpluses over 5% in 2006 and 2007. Mention large debt increase, but say that net debt should be kept to a more manageable ratio of about 66%. "The government's debt position appears precarious on the basis of gross debt."
4. IMF objected to central bank rate cuts; causing some consternation in Iceland. There is growing animosity toward the IMF. The coalition may be fighting over fiscal policy.

#### **2010M1:**

1. Deficit is expected to be reduced to 9% of GDP in 2010. A number of tax increases planned. Will raise revenue from 30% of GDP in 2010 to 34-35% by 2013.
2.
  - "Economic policy will be focused on rehabilitating the public finances and trying to alleviate the impact of recession." "The 2010 budget is in line with IMF conditions foreseeing substantial direct and indirect tax increases and expenditure cuts to bring down the budget deficit." Conditionality seems main reason (e). "Despite the fact that there has since been a change of government, policy remains conditioned by the programme agreed with the IMF in November 2008."
  - Market access (d) also seems important. "Despite the government's austerity measures, agencies have reduced credit ratings on Iceland's sovereign debt, precipitating a rapid increase in interest rates for many energy companies and municipalities, even where international financial institutions have restarted their lending."
  - "The government continues to work within the conditions set by the initial IMF programme, with the 2010 budget ... indicating an even stricter fiscal stance than prescribed in the programme." Could suggest an element of their own ideas (f) or

- concern about market access (d). There is a long discussion of all the things the government is doing to tackle the deficit. It feels like they are willing participants.
3. Same discussion as in the previous issue of “[a] massive deterioration in the public finances took place in 2009.” EIU certainly mentions debt; says again that net debt is substantially lower. “Despite the government’s austerity measures, agencies have reduced credit ratings on Iceland’s sovereign debt.”
  4. Monetary policy is easing some.

**2010M7:**

1. Deficit of 9.1% of GDP in 2009. “The government is expected to introduce further spending cuts worth about 2% of GDP and tax rises worth 1% in its 2011 budget.” “The 2011 budget is to deliver an adjustment of 3% of GDP, leading to a general government primary surplus.” So, austerity is continuing.
2.
  - “We expect that, despite protests, the government will keep to the IMF programme agreed in late 2008 ... to reduce the public-sector deficit.” So, motivation is partly at least (e). “The leaders of the two parties [in the coalition] have continued to agree on implementing the IMF programme, including fiscal consolidation, but several LGM members are in open disagreement with the government.” This suggests the conditionality is binding. “A key test will be the passage of the 2011 budget ..., which will require more expenditure cuts and tax rises.” “Fiscal policy has become the main focus of the economic programme following the recapitalisation of the commercial banks and increased currency stability.”
  - “The Icelandic government put great emphasis on the approval of the second review, as it opened access to funding that should put to rest lingering doubts over the government’s access to external financing to meet redemptions of large foreign-currency loans due in late 2011 and early 2012.” Could suggest some (likely small) role for concern about market access (d).
3. “Gross government debt is expected to rise from 28% of GDP at end-2007 to about 130% of GDP at end-2010, partly as a result of meeting the obligations of the three failed Icelandic banks and the injection of new funds to recapitalise them. However, net debt should be kept to a more manageable ratio of about 60% of GDP.”
4. Second quarterly review from IMF was approved.

**2011M1:**

1. EIU expects continued drops in the deficit. Deficit is coming down, but it is unclear whether this is just due to growth or to action. Taxes did rise, but general government spending has increased slightly year-on-year.
2. “In the short term, economic policy will be conditioned by the IMF agreement, which may be extended. We expect to see continued progress in reducing the government deficit, but this could be derailed by political instability.” So conditionality seems to continue to play a central role (e). Political concerns (c) also may be a factor.
3. Government is promising to do more to help indebted households “despite promises to the contrary in a Letter of Intent to the IMF in September.” Same discussion of the government debt as in previous issues.
4. There is some disagreement among the coalition over the IMF programme. Could lead to political instability and a change in policy.

**2011M7:**

1. “We expect the coalition to continue its progress on reducing the fiscal deficit and rehabilitating the banking system.” Deficit is down to 3.5% in 2011Q1. Deficit down in

- large parts because of lower interest payments.
2. IMF programme set to end in August 2011, “but some form of co-operation will probably continue.” Could mean that IMF conditionality is still a motivation (e). After discussing the success so far in dealing with fiscal problems, the EIU says: “However, there is a risk that the programme could be derailed by a government collapse and subsequent election in which the main parties compete by promising less stringent policies.” So, politics (c) and ideas (f) could play a role in the future.
  3. Exactly the same discussion of gross and net debt as before. “Two and a half years after the financial collapse of October 2008, the Icelandic state re-entered the capital markets, which expressed surprisingly strong interest.” “Critics ... pointed to high rates of about 5% on the bonds.”

### **2012M1:**

1. “The 2012 budget was passed in parliament by one vote in December. Cuts and tax rises were criticised by the opposition parties. The general government deficit fell only moderately to 4.7% of GDP in the first nine months of 2011.” “It [the deficit] should fall further in 2012 owing to new austerity measures in the budget, although the process will be held back by a forecast economic slowdown.”
2. “Policy should continue to be driven by the need to stabilise the economy, rebuild the banking system ..., and reduce the government deficit.” This is the same wording there has been in previous issues. It is not clear what motivation this suggests—most likely market access (d). IMF program is over: “Although some co-operation with the IMF will continue, it will no longer be a significant policy anchor.” So, probably not (e). Politics is playing some role (c): “We expect little additional progress in 2013 owing to the government’s likely reluctance to risk further unpopularity as the election of April 2013 approaches and probable promises by the parties that win to ease austerity.”
3. Mentions debt-to-GDP is 109.5%. S&P rating improves. “The last time the Icelandic state sought funds from the global financial markets was in June 2011.” “Although this was well received, the state has not attempted further offerings since then. At the end of November, however, there was positive news that could support further such offerings in future.” S&P changed rating from negative to stable.

**Bottom Line: Iceland initially engaged in a large fiscal expansion related to financial rescue. Then, there was substantial fiscal contraction due to loss of market access and subsequent IMF and Nordic conditionality. The IMF, however, did not force much contraction in 2009, when the recession was at its worst. There was a small continuing role for market access in fostering austerity because ratings on sovereign debt affected borrowing costs of municipalities and companies. Also there may have been a small role for domestic policymakers’ own ideas—at times the government seemed to go further with austerity than the IMF required. In addition, there was a fight within the governing coalition, suggesting again that ideas mattered.**

## **UNITED KINGDOM (2008:1)**

### **2008M1 (pre-crisis):**

1. "Public expenditure on the health and education sectors will rise further, but the feeble state of the public finances will ensure that this happens at a far slower rate than during Labour's second term in office." "The fiscal position will remain weak over the outlook period. The Treasury expects the general government financial deficit (GGFD) to decline from 2.9% of GDP in 2007 to 2.4% of GDP in 2009, but there are reasons for treating its projections with some scepticism."
2. (f): To the degree that there is fiscal expansion above what is being caused by slowing growth, it seems to be based on ideas about public services (health and education), rather than about how the economy works. (See 1 above.)
3. "With the structural deficit on the public finances in 2007 estimated to be the highest in the EU15, at 3.1% of GDP, the cyclically unadjusted GGFD is not expected to fall below 3% of GDP over the outlook period. The rapid expansion of the financial services and housing sectors in recent years has given a healthy boost to tax revenue growth, but both sectors are expected to weaken this year, placing further pressure on the fiscal position."
4. "The financial crisis at a mortgage lender, Northern Rock." "Housing market continues to weaken."

### **2008M7:**

1. Economic downturn is depressing tax revenue. "Public expenditure on health and education will rise further, but the feeble state of the public finances will ensure that this happens at a far slower rate than during Labour's second term." "Despite a steadily rising tax burden, the fiscal position has deteriorated sharply since 2000, with the general government budget posting a deficit of close to 3% of GDP every year since 2003. The parlous state of the public finances means that the government, rather than using fiscal stabilisers to mitigate the economic downturn, is being forced into a spending squeeze." In another place, the EIU seems to say deficit will rise to 3.8% of GDP in 2008 and 4.4% in 2009.
2. Sounds like the UK is not having expansionary fiscal policy because of the deficit, but the EIU doesn't really explain why.
3. Much discussion of the fragile state of the public finances, but that seems to be the EIU, not policymakers.
4. Economy is slowing more sharply than expected.

### **2009M1:**

1. Overall, expansionary. Not enormous.
  - UK has done a substantial bank rescue and a quite small stimulus (20bn pounds) (in the form of a cut in the VAT rate). EIU is predicting a huge rise in the deficit (13% of GDP in 2010).
  - "Despite the £37bn (US\$57bn) recapitalisation of the banking system, lenders are becoming increasingly cautious as they seek to reduce their liabilities and strengthen their capital bases (as, indeed, they have been told to do by financial regulators and the government)." This part seems of moderate size.
  - "Over the eight-month period as a whole revenue rose by just 0.5%. In contrast, spending by central government rose by 6.2% year on year in November 2008 and by 6.1% in the April-November period. The public finances will continue to deteriorate over the remaining four months of the financial year, as declining economic activity depresses revenue and the government provides additional financial support for pensioners and families."

2.
  - Main reason seems to be financial rescue (a): “Economic policy is almost entirely focused on managing the escalating financial and economic crisis. The unprecedented moves last year to support the banking sector will have enormous policy implications for years to come, in terms of the government’s mounting financial commitments and the state’s increasing role in the economy.” It is a bit hard to tell how much of the financial rescue is in the form of guarantees and how much is actual fiscal cost.
  - A bit of (b): “£20bn (US\$30bn) fiscal stimulus package (the main element of which is a temporary cut in the rate of value-added tax (VAT) from 17.5% to 15% until end-2009).” Some discussion of the government announcing higher taxes and severe spending restraint after 2010 to put finances on a more stable footing over the medium term.
3. “The public finances will deteriorate sharply. As pressure on the state balance sheet increases, so will concerns over the UK meeting its debt obligations.” “The UK has one of the largest structural deficits in the OECD.” Dramatic worsening of the UK’s public finances. EIU discusses that the government currently has low bond yields. EIU is surprised. Thinks it must be a bond bubble developing.
4. Further financial rescue will be needed.

#### **2009M7:**

1. Lots of measures to support the banking sector. “[O]ne of the smallest discretionary fiscal stimuli among the G7.” “Government measures to support the banks (via state-funded loans, guarantees and capital injections) total £1.3trn (US\$2trn; about 90% of GDP), with the state holding a majority stake in two of the UK’s largest banks. A taxpayer-backed insurance scheme to underwrite these banks’ most toxic assets aims to reduce investor uncertainty and encourage greater lending, but it raises serious concerns about moral hazard and exposes the government balance sheet to formidable risks.”
2.
  - (a): See the description above for all of the things policymakers are doing to help the financial system.
  - “Concerns about the fiscal position will increasingly dominate policy debate as the public finances deteriorate at an alarming rate in 2009-10. This will necessitate a prolonged period later of higher taxes and public spending restraint.” There is a bitter spat in parliament over public spending plans (this provides evidence of Cameron’s ideas, which will be relevant later). Mr. Brown denies that public services will have to be cut. It sounds as if ideas (f) are driving the debate. EIU says: “regardless of its political colour, the next government will have no option but to implement a major fiscal tightening over the parliamentary term.” Is this because they are worried about market access, their ideas, or just going on autopilot? It is impossible to tell.
3. Mentions the high structural deficits. EIU is very negative—says “the concern is that investors could lose confidence in the country’s ability to meet its debt obligations. There is now a high chance that the major rating agencies will downgrade the UK’s triple-A long-term sovereign rating.” EIU admits that investors “have shown surprisingly little concern about the UK’s rapidly deteriorating fiscal position.”
4. Mervyn King says the government’s fiscal deficit is a threat to macroeconomic stability.

#### **2010M1:**

1. Any consolidation measures will be delayed until at least 2011 when policymakers hope economic recovery will be established.

2. Nothing new is being done. Main reason remains financial rescue (a). Not doing fiscal stimulus, perhaps because the budget is a problem—but that is at most implicit. EIU says that lots of people (BOE, IMF, OECD) are concerned, and that government felt the need to set out a blueprint for consolidation. EIU says that rating agencies confirmed UK's rating, but made it clear that it is dependent on policymakers moving quickly to put a medium-term fiscal framework in place. So, may be a bit of market access (d).
3. EIU pro-conservatives: "The party has offered a seriousness of purpose in at least acknowledging the painful fiscal consolidation that lies ahead, in contrast to the often nonsensical claims of Mr Brown, but voters (and investors) are yet to be convinced by its policy stance." Says a downgrade could drive up interest rates. Again, the EIU is agitated, but not clear that current policymakers are. "So far, investors have not taken fright." Spreads are up just a small amount.

#### **2010M7:**

1. Expecting fiscal austerity from the new government. "A dramatic five-year fiscal tightening programme." Discretionary tightening of 113bn pounds is planned by 2014/15. Mostly spending cuts. "The scale of fiscal tightening implied in the budget is immense." "The new coalition's emergency budget in June detailed a five-year programme of drastic (and ambitious) fiscal tightening."
2. "The budget's austere tone has reduced near-term market concerns over fiscal sustainability." Could be that concern about market access was a motivation (d). The EIU says: "The chancellor justified the extent of the fiscal squeeze on the grounds that it was needed in order to retain the confidence of the markets." Even the EIU says that "there is no indication that investors are shunning UK gilts." "Despite record issuance, the UK bond market has been one of the strongest in industrialised economies this year." The fact that there seems to be no genuine problem with market access could mean that the main source of austerity was ideas (f).
3. EIU thinks debt is a problem and needs to be dealt with. The government wants to start reducing debt (presumably relative to GDP): "The coalition's emergency budget on June 22nd set out an ambitious five-year plan for fiscal consolidation, with the aims of eliminating the structural hole in the public finances and placing the public debt burden on a declining path." And EIU cites "[i]nvestor concerns over rising public debt."

#### **2011M1:**

1. Substantial fiscal austerity.
2. "The austerity plan has eased near-term concerns over fiscal sustainability." "The dominant issue will be how the coalition reconciles its twin aims of deficit reduction—to fix the fragile public finances—and economic recovery, with policy action in many areas being dictated by fiscal constraints." "The austere tone of the deficit-reduction programme and comparatively low government borrowing costs have tempered market concerns over fiscal sustainability." It seems possible that market access could be a motivation (d), but it is not clear. The EIU is so doctrinaire when it comes to UK fiscal policy that they may be untrustworthy. For example: "The government has been criticised in some quarters for targeting too rapid a pace of deficit reduction at a time of economic uncertainty and minimal funding pressures, but there is no accepted orthodoxy on the impact that fiscal austerity will have on economic activity." It seems likely that ideas (f) were a main motivation, since even the EIU says there are minimal funding pressures.

#### **2011M7:**

1. "Efforts to shrink the UK's largest-ever peacetime budget deficit will dominate policy

debate. A dramatic five-year fiscal tightening programme will entail tax rises and the deepest sustained period of public spending cuts since the 1940s.”

2. “The austerity plan has eased investor concerns over fiscal sustainability.” So, it could be that market access concerns (d) were important. EIU mentions that UK has advantages over countries like Greece. Although “George Osborne, insists that weak economic activity will not deflect the coalition from its aggressive deficit-reduction plans, a degree of vacillation has become apparent in other policy areas.” Could suggest ideas (f) are crucial.
3. EIU mentions once again that the UK has “one of the largest structural deficits in the OECD.”

### **2012M1:**

1. OBR has revised down its estimates of growth and potential, leading the government to announce additional austerity measures beyond 2015. Deeper austerity plans announced in late 2011 have total discretionary tightening of 8% of GDP per year by 2016/17 fiscal year. “Efforts to shrink the UK’s largest-ever peacetime budget deficit will dominate policy debate. An ambitious five-year fiscal tightening programme entails tax rises and the deepest sustained period of public spending cuts since the 1940s.”
2. Sounds like ideas (f) are the main thing (Osborne seems to believe in expansionary fiscal contractions); with perhaps a touch of market access (d): “An emergency budget in June 2010 set an ambitious five-year programme of fiscal tightening, with the dual aims of eliminating the estimated ‘current structural deficit’ (that is, excluding investment spending and the cyclical deficit) and placing the public debt/GDP ratio on a declining path.” There are also concerns about market access, and a sense that concerns about future market access are important: “The chancellor, George Osborne, has continued to cite Britain’s low borrowing costs as evidence of investors’ confidence in the government’s management of the economy. He argues that yields are low because investors view the austerity programme to be credible and believe the coalition will stick to its stated targets.” And, “The austere tone of the deficit-reduction plan helped to temper earlier market fears over fiscal sustainability, but the threat remains and public opposition will continue to swell as unemployment rises and cuts in welfare spending and public services bite.”
3. Gross debt had been 53% in 2008; 80.1% at mid-2011 and expected to rise steadily. An explicit goal is to reduce debt/GDP (see (2) above). EIU points out that borrowing costs are low. Says it is not because austerity plan is viewed as credible (as Osborne suggests), but rather because BOE is perceived as willing to buy large quantities of debt. EIU says there is a high probability that UK will lose its AAA sovereign rating in the coming years.
4. EIU now admits there will be no expansionary fiscal contraction. Predicting a recession.

**Bottom Line: The U.K. spent a substantial amount on financial rescue, but did only a very small amount of conventional fiscal stimulus. With Cameron’s election in May 2010, the government switched to extreme austerity. The government said that future market access was the reason, but the EIU emphasized that actual market access was excellent. This juxtaposition may suggest an important role for ideas.**

**AUSTRIA (2008:2)****2008M7 (pre-crisis):**

1. Expansionary.
2. (i): Growth is leading to higher tax revenues and a falling budget deficit; policymakers are responding by taking expansionary fiscal actions. That is, procyclical policy. “With economic growth remaining strong in the opening months of 2008, gross tax revenue increased by ... more than the government previously expected.” “[A] key priority of the coalition will be to increase research and development (R&D) expenditure .... The government will also continue to invest in infrastructure upgrades.”
3. Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t cite it as a problem or connect it with anything.

**2009M1:**

1. Expansionary. There are two stimulus packages, which together come to almost exactly 1% of GDP. And potential capital injections that are “up to” slightly more than 5% of GDP.
2. (b) and (a) (plus a tiny bit of (i), perhaps—carryover from the pre-crisis situation—see above). “The focus of the new government’s economic policy is to help consumers and businesses weather the accelerating economic downturn. The administration will be responsible for implementing two economic recovery packages, which aim to boost consumer purchasing power. ... The government will also focus on taking measures to shore up liquidity in the banking sector. It has agreed to provide up to €100bn in aid, of which €85bn will be in deposit guarantees and the remaining €15bn in the form of new equity to boost banks’ capital levels.”
3. Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t cite it as a problem or connect it with anything.
4. Major banking problems!

**2009M7:**

1. Expansionary. The only things that are clearly new are, “Parliament passed a labour market package designed to create or safeguard 34,500 jobs, largely by enabling companies to employ people on short-working hours” (this would be equivalent to about 1.5 million jobs in the U.S., which is large, but the amount of actual government spending appears small); and, “the government agreed ... to provide medium-sized and large companies with special loan guarantees of up to €300m,” which isn’t conventional stimulus.
2. (b) for the new measures; (b) and (a) for the earlier ones. “The focus of the government’s economic policy is to help consumers and businesses weather the economic downturn. The administration is implementing a series of economic recovery packages to boost domestic demand.” And, “Austria’s government will also focus on taking measures to shore up the banking sector. It has agreed to provide up to €100bn in aid, of which €85bn will be in deposit guarantees and the remaining €15bn in the form of new equity to boost banks’ capital levels.”
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t cite it as a problem or connect it with anything.
  - There’s a mention of outside forces, but EIU doesn’t think they’ll matter: “In late June the European Commission announced that it will initiate the excessive-deficit procedure (EDP) against Austria in late 2009. Given the large number of countries that will come under the EDP this year, we do not expect the Commission to levy

- finances on Austria.” (And similar language later in the report.)
4.
    - Major banking problems!
    - Policymakers are talking about possible austerity measures, but are not yet taking action. To the extent a motivation is implied, it’s that the deficit is a problem in its own right (f).

**2010M1:**

1. Roughly neutral: the government recently nationalized a bank, and one of the two parties in the governing coalition proposed a small additional stimulus package. But the EIU doesn’t expect it to happen, and some policymakers are arguing that fiscal policy should move to austerity, which the EIU thinks will happen at some point.
2. On the expansionary side: (b) and (a). On the contractionary side: mainly that the deficit and debt are a problem in their own right (f); also some EU pressure (g). “The short-term focus of the government’s economic policy is to help consumers and businesses weather the economic downturn. ... Mr Faymann [Chancellor] is in favour of implementing a third stimulus package aimed at boosting employment, but the ÖVP [second party in the coalition government] is opposed on the grounds that Austria must focus on reducing its rapidly rising budget deficit and public debt. We do not expect a third stimulus package to be passed by parliament, and Mr Pröll [vice-chancellor, from ÖVP] has indicated that the government will begin to unwind its fiscal stimulus measures as it seeks to prepare for austerity measures from 2011.” Mr Pröll “[claimed] that Austria must focus on reining in its rising government deficit and public debt.” “The European Commission has given Austria until 2013 to bring the deficit back below 3% of GDP.”
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t connect it with anything. A slight hint that the EIU views it as a problem—they describe the possibility of it rising more than expected as a “risk,” which suggests they view it as undesirable.
  - There’s a mention of outside forces: “The European Commission has given Austria until 2013 to bring the deficit back below 3% of GDP.”

**2010M7:**

1. Contractionary. EIU gives numbers that add up to about 2% of GDP, “but many of the specific measures to cut expenditure and raise taxation have yet to be decided.”
2. The deficit and debt are a problem in their own right (f); and European Commission rules/pressure (g). “The government is preparing a series of expenditure cuts and tax increases in 2011 to reverse the rise in the budget deficit.” “A budget framework programme for 2011-14 that is currently before parliament foresees the deficit falling below the 3% of GDP euro zone threshold from 2013 (this target has been agreed with the [European] Commission).”
3. Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t cite it as a problem or connect it with anything.
4.
  - GDP and employment are growing.
  - One small expansionary action: extension of program to support banks (a).
  - There’s a guaranteed minimum income, but it seems to be a rationalization of existing benefits rather than an increase in benefits.

**2011M1:**

1. Slightly contractionary. Numbers are the same as in the previous report, but some

specifics have now been adopted.

2. Seems to be driven mainly by European Commission rules/pressure (g), plus a sense that the deficit and debt are a problem in their own right (f). Strong growth is causing the deficit to fall on its own, leading policymakers to want to scale back the proposed austerity measures. So: things seem to be driven by the 3% target (which has the effect of making fiscal policy procyclical). “The government is preparing expenditure cuts for 2011 to reverse the increase in the budget deficit.” “A Stability Programme for 2010-13, to bring the deficit below the euro zone threshold of 3% of GDP from 2013, was submitted to the European Commission in January 2010. ... However, better than expected budget figures for 2010 owing to higher economic growth, mean that both parties are calling for modification of the austerity framework.”
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don't cite it as a problem or connect it with anything.

### **2011M7:**

1. Slightly contractionary. No apparent changes since previous report.
2. Very similar to previous report. So (g) and some (f). “The coalition has agreed in principle with the European Commission in its 2010-13 Stability Programme to act to reduce the government deficit to below 3% of GDP by 2013.” “A Stability Programme for 2010-13, to bring the deficit below the euro zone threshold of 3% of GDP from 2013, was submitted to the European Commission in January 2010. ... However, better than expected budget figures for 2010, owing to higher economic growth and a decrease in government consumption, mean that both parties are calling for modification of the austerity framework.”
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don't cite it as a problem or connect it with anything.
  - Report that IMF Article IV draft says that the deficit and debt are too high. (This is in the “Monthly review” part of the report; EIU doesn't make a big deal of it.)
4. Other than the mention of the IMF, the relevant parts of this report are extremely similar to January 2011.

### **2012M1:**

1. Mildly contractionary. There are some “[c]ost-curbing measures that are currently envisaged for 2012” that sound small; a goal of “savings of €2bn per year [0.7% of GDP] ... over the next five years”; and, “A debt [actually, deficit] ceiling limiting the [structural] deficit to 0.35% of GDP from 2017 has been passed as law.”
2. EIU says very little about motive. If one were reading just this report, best guess would probably be that they view high deficits and debt as a problem in their own right (f). Earlier reports suggest a role for (g).
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don't cite it as a problem or connect it with anything.
  - There's one mention of the budget plan submitted to the European Commission in early 2011. The sentence is very similar to ones in previous reports.
4. Economy appears to be turning down. But EIU gives no indication that this is affecting fiscal policy in either an expansionary direction (to counteract the downturn) or a contractionary one (to keep on track with the deficit targets).

**2012M7:**

1. Contractionary. “The government passed an austerity package in March 2012 to save €26.5bn by 2016 and submitted an update of the Stability Programme, to balance the budget in 2016, to the European Commission in April 2012.” €26.5 is 9% of a year’s GDP. It’s probably a multi-year number, however, since the current deficit is 2.6% of GDP.
2. EIU makes clear that the government is committed to austerity, but says little about why. Seems to be a mix of the view that the deficit and debt are a problem in their own right (f); and European Commission rules/pressure (g). “During the forecast period, economic policy is likely to be characterised by efforts to stabilise the public finances and the banking system .... The coalition has agreed in its Stability Programme for 2011-16 to bring the government deficit below 3% of GDP by 2013, and has passed a debt ceiling law that limits the federal deficit to 0.35% of GDP from 2017.” “The government passed an austerity package in March ... and submitted an update of the Stability Programme, to balance the budget in 2016, to the European Commission in April.”
3.
  - Mention the debt-to-GDP ratio, its recent changes, and its expected short-run changes. But don’t cite as a problem or connect with anything.
  - Mention an update to the budget plan submitted to the European Commission, submitted April 2012.
  - Say that parliament just recently ratified the EU “fiscal pact,” which limits deficits (with exceptions for economic crises and natural disasters).

**Bottom Line: Fiscal policy in Austria was initially mildly expansionary for countercyclical reasons and financial rescue, but there was then a switch to substantial austerity. The change appeared to result roughly equally from EU rules and from domestic policymakers’ ideas about the benefits of fiscal rectitude.**

## **FRANCE (2008:2)**

### **2008M7 (pre-crisis):**

1. Currently expansionary, but there are mild plans to shift to austerity.
2.
  - On the expansionary side: (b)? EIU says little, but does say, "The government has sought to stimulate demand through tax reductions in 2008." And elsewhere they say the economy is weakening.
  - On the contractionary side: Mainly (f) (deficits are bad in their own right and should be dealt with) and a perhaps a tiny bit of (g)? EIU again says little. The main thing is, "the government will make a belated attempt at fiscal consolidation in 2009" (by freezing real public spending and limiting government hiring). Mention SGP rules, but don't view them as a big deal: EIU "expects the deficit to exceed the ceiling of 3% of GDP set by the EU's Stability and Growth Pact .... In May 2008 the European Commission sent an 'early warning' to France regarding the state of its public finances, but ... France is likely to avoid any harsher [penalties]."
3. EIU doesn't explicitly say the deficit is a problem, but implies it needs to be dealt with.
4. "[G]lobal credit crunch"; "slowdown" in France. Government is working on supply side/structural reforms.

### **2009M1:**

1. Expansionary, though size is constrained by the fiscal situation (for reasons not made clear in this issue). Stimulus is 1.3% of GDP; financial rescue has made "up to" 2% of GDP of "fresh capital" available, though the next report says that France's banks are in better shape than most.
2.
  - (b): "managing the economic downturn will be the government's main priority"; "The government's short-term priorities will be to alleviate the effects of an economic slowdown through measures to support business investment, employment and the incomes of unemployed and low-paid workers"; "fiscal stimulus package worth an estimated €26bn."
  - (a): "In exchange for state support for the financial sector, Mr Sarkozy will seek to ensure that banks maintain the flow of credit [to] businesses." "Having offered state guarantees and capital injections for the French banking and financial system."
  - Also, "Government promises new help for automotive sector."
3. EIU discusses the deficit but doesn't explicitly say it's a problem. But they do say, "France's ability to set the [global] economic policy agenda will be constrained by the dire state of the country's public finances." And imply that the fiscal situation is constraining the response, though they don't say why: "One clear shift in economic policy is an acceptance that the general government budget deficit will rise. ... The main impact [of the stimulus package] ... will be felt through the front-loading of planned public investment in 2009-10. Other initiatives also amount to little more than changes to the timing of state disbursements, so the medium-term impact on the public finances should in theory be limited. The government will continue to try to control aspects of current spending during 2009-10." Also, the report mentions that the deficit exceeds the SGP 3% ceiling, but, "France will avoid facing any financial penalties" because higher deficits are allowed when growth is negative.
4. "[G]lobal economic and financial crisis"; "prospect of deep recession in 2009" in France.

### **2009M7:**

1. Expansionary.

2. (b) and (a). There have been new countercyclical actions, though they seem small; there don't appear to have been new financial rescue actions. "The government's short-term priorities will be to alleviate the effects of an economic downturn through measures to support business investment, employment and the incomes of unemployed and low-paid workers." And, "to support liquidity and strengthen the banks' balance sheets, the state has guaranteed new bank lending up to €320bn and will provide up to €40bn in fresh capital."
3. EIU discusses size of the deficit. The deficit is clearly viewed as a problem by both policymakers and the EIU: "a ballooning deficit will limit [the government's] room for manoeuvre," "strains on France's public finances," head of Banque de France is concerned, etc. Mention that the deficit is far above SGP threshold, but say, "France will avoid facing any financial penalties," since many other EU countries are in the same boat. A more significant mention of potential outside pressure: "The emphasis upon short-term government spending to stimulate the economy places Mr Sarkozy in potential conflict with the German government, the European Commission and the European Central Bank (ECB), which have all been critical of the rapid rise in deficit spending in Europe." Government is saying it will move to austerity "once growth revives" or "once the economy recovered" ("Mr Sarkozy said that he would not seek to introduce austerity measures to curb the rising deficit, but said reforms would be necessary once growth revives"), and it's giving some indications of possible concrete measures. But no actual policies.
4. "[G]lobal economic and financial crisis"; "deep economic recession in 2009" in France. "On the whole, French banks are in better shape than their counterparts in most other large European countries (the UK in particular)."

### **2010M1:**

1. Expansionary. Some stimulus measures are being "withdrawn," but others are being extended and new ones added. Not clear if the net change since 2009M7 is expansionary or contractionary.
2. (b). "Mr Sarkozy's government will continue to pursue an interventionist programme to underpin employment and try to ensure a sustainable recovery."
3.
  - EIU discusses size of the deficit, and debt/GDP and its projected increase. Deficit and debt clearly viewed as a problem. Also, there are mentions of potential issues involving SGP, other European pressure, and bond ratings. The SGP is viewed as no big deal (for the same reason as before). "However, there remains a potential for a clash with the European Commission and other euro area countries later in the outlook period." Mention of ratings is vague/distant: "the servicing charge on France's general government debt is equivalent to almost 7% of general government receipts, although this is still 3 percentage points away from the 10% threshold that would typically threaten a country's AAA rating for sovereign debt."
  - A small sense that the debt is affecting policy: a long discussion of the debt, its projected increase, and the just quoted discussion of interest payments on the debt is followed by, "Mr Sarkozy and Mr Fillon are hosting a national conference on the public finances at the end of January, with the aim of reaching agreement on a new set of budget rules to ensure future fiscal sustainability."
4. "[T]he economy is slowly recovering." Policymakers plan to move to austerity at some point, but nothing is happening, and EIU says, "Significant corrective measures are not expected until 2012." (Also, a court ruling about a carbon tax isn't quantitatively important—about 0.1% of GDP.) Here and in later reports, they often mention that

debt/GDP may soon reach 90%. But it's not clear that they attach any special significance to 90%.

#### **2010M7:**

1. Contractionary. Some stimulus measures are still continuing, and maybe some small ones are being added. But on net stimulus is declining, and recent actions and proposals focus on austerity. Other than an increase in the retirement age, the measures seem fairly small.
2. Mainly (f), some (d) and (g).
  - (g): Some mention of international pressure: "Germany will press for more intrusive budget monitoring of euro area members, which would be likely to stoke further tension with France." There's a mention of the deficit violating the SGP rule, but no mention of consequences.
  - (d): One mention of possible loss of market access: "there is a risk that international investors could demand a significantly higher premium for holding French public debt." (Also, EIU thinks, "Markets may currently be underpricing risks to France.")
  - (f): Mainly, EIU and French policymakers seem to just take it as given that austerity is needed. EIU discusses the deficit, the level of debt and its projected rise, and long-term pension problems without clearly saying what it views as central (and is even less clear about what policymakers think). "Fiscal policy will remain accommodative in 2010, but support will be scaled back in 2011 as the French government tries to reduce the budget deficit"; "the prime minister ... is spearheading efforts to consolidate the public finances"; "the government is now considering how the general government budget deficit can be brought down over the medium term"; "The condition of France's public finances is precarious. ... France's [pre-crisis fiscal] position was poor. The deficit rose from 3.3% in 2008—already above the ceiling of 3% of GDP set by the EU's Stability and Growth Pact (SGP)—to 7.5% in 2009 .... Public debt rose from 67.5% in 2008 to 77.6% in 2009, and is forecast to rise to just under 90% by 2011. ... It has done a reasonable job of controlling central government spending ... but faces a burgeoning deficit on the social security accounts (including pensions), which will be difficult to correct in the short term."
3. See above.
4. "[S]overeign debt crisis in the euro area."

#### **2011M1:**

1. Contractionary. Again, seems small—"mildly restrictive."
2. Mainly (f), some (d), a little (g). No mention of violating SGP rules, and only a vague mention of outside pressure: "the tussle between [France and Germany] looks set to continue, given Germany's emphasis on the need for strict fiscal discipline." A serious mention of risks to bond rating: "With public debt forecast to rise to close to 90% of GDP by 2012, an additional risk is that France could lose its AAA rating on sovereign debt, which would push up interest costs." But mainly, EIU and French policymakers seem to just take it as given that austerity is needed, though this is more implicit than explicit: "the need to reduce the deficit [is] an overriding policy aim"; "the added pressure on the already weak public finances"; "more radical changes to the welfare system will be needed to ensure fiscal sustainability in the long term."
3. EIU discusses size of the deficit, and debt/GDP and its projected increase.
4. European debt crisis is continuing.

#### **2011M7:**

1. Contractionary (though not much new is going on).

2. Mainly (f), some (d). No mention of violating the SGP rule or of conflicts with Germany. Repeats the mention of risks to bond rating: “With public debt forecast to rise to close to 90% of GDP by 2013, there is a risk that France could lose its AAA rating on sovereign debt, which would push up interest costs.” But mainly, EIU and French policymakers seem to just take it as given that austerity is needed. For example, one “legacy of the 2008-09 downturn” is “a need for fiscal tightening.”
3. EIU discusses size of the deficit, and debt/GDP and its projected increase.
4. European debt crisis is continuing. Whole report is very similar to previous.

#### **2012M1:**

1. Contractionary. There are some expansionary actions, which the EIU attributes to (b) and (c) (upcoming election). Says, “The government has turned its attention ... to how best to promote employment and stimulate growth, with Mr Sarkozy announcing a flurry of new measures since the start of 2012 [that is, in the past few weeks].” (And the preceding sentence starts, “With less than four months until the presidential election.”) But there doesn’t appear to be anything substantive—see top of p. 17. In contrast, “a series of austerity measures announced by the French government during the latter half of 2011 to ensure that deficit-cutting targets are met, even in the face of weakening economic growth” seems real. “The aim is to cut the structural deficit by 1.5% of GDP,” though the EIU is skeptical and presumably this is partially offset by the expansionary measures.
2. Mainly (f), some (d). There’s likely to be a downgrade. But, “Possible loss of France’s AAA rating is downplayed,” and EIU sees it only having a small impact on interest rates. More generally, the tone and discussion suggests that the push for austerity is far more general. As before, EIU and French policymakers seem to just take it as given that austerity is needed. For example, “the president will seek to demonstrate that he is not just the candidate of austerity” (suggesting that he is *mainly* the candidate of austerity); “Over the past year, [the president and prime minister] have presented themselves as France’s best hope to steer the economy in the perilous waters of the euro area sovereign debt crisis, meet deficit reduction targets and retain an AAA credit rating”; “The deteriorating economic outlook since mid-2011 has forced the government to outline a series of corrective measures to meet the target of cutting the budget deficit from 5.7% in 2011 to 4.5% in 2012.”
3. EIU discusses size of the deficit, and debt/GDP and its projected path.
4. There are now stronger EU fiscal rules, but EIU doesn’t describe them as affecting policy.

#### **2012M7:**

1. Contractionary. There is a reference to “sharp fiscal tightening,” but seems more a reference to what the EIU expects than to what has actually been done or proposed. Later, there is a reference to needing another 0.5% of GDP of consolidation.
2. Mix of (g), (f), and (d), probably with (g) first. For example, “To honour France’s commitments under economic and monetary union, and to retain financial market confidence in French sovereign debt, the new government has little choice but to implement unprecedented fiscal consolidation.” Lots of references to deficit targets that France has agreed to, and a fair number to risk of loss of confidence. (For example, “Public debt is approaching a level that makes France vulnerable to a loss of investor confidence.”) But, still true that seem to take it as given that austerity is needed.
3. EIU discusses size of the deficit, and debt/GDP and its projected path.
4. Hollande has replaced Sarkozy. But he too believes in austerity.

**Bottom Line: France initially undertook mildly expansionary fiscal policy for countercyclical purposes and financial rescue. But the size was limited, and policy soon switched to austerity and then remained mildly contractionary. The limitations on the size of the initial expansion and the initial move to austerity were driven mainly by domestic policymakers' ideas about the benefits of fiscal restraint. But market access issues and EU rules both played nontrivial roles in the continued austerity.**

## **ITALY (2008:2)**

### **2008M7 (pre-crisis):**

1. "The fiscal deficit fell to 1.9% of GDP in 2007, but it is expected to edge up towards the Stability and Growth Pact's ceiling of 3% in 2008 and 2009." "Strong revenue growth driven by the pick-up in economic activity and a clampdown on tax evasion helped reduce the budget deficit to 1.9% of GDP in 2007, from 3.3% in 2006 and 4.2% in 2005. However, there is a moderate risk that the recent process of fiscal consolidation will be reversed in the next few years and the deficit will breach the 3% ceiling for euro area countries." At the same time, the government has committed to achieving a balanced budget by 2011.
2.
  - "The new government's main challenge will be to boost households' purchasing power ... and stimulate economic activity, without reversing the improvement in Italy's public finances that was achieved in 2006-07." It sounds as if countercyclical (b) or ideas (f) is driving fiscal policy. There will be "strong pressure to cut taxes in the coming years, given his coalition's election promise to reduce gradually the tax burden over five years."
  - EU rules might be playing some role (g): "The external constraint of the EU's Stability and Growth Pact should nonetheless keep it [the deficit] below the ceiling for euro area countries."
3. "With economic growth expected to be weaker in 2008 and 2009 than originally projected and interest payments on Italy's large public debt burden projected to rise further (the spread on Italian long-term government bonds vis-à-vis equivalent German bunds has widened from about 25 basis points in July 2007 to about 60 basis points in June-July 2008)." Government has pledged to get debt/GDP below 100% by 2011 (currently 103.9%).

### **2009M1:**

1. Fiscal deficit is forecast to rise from 2.8% in 2008 to 3.5% in 2009-10. "Much larger deficits cannot be ruled out as our forecast assumes that the economy minister ... will resist pressure for tax cuts to boost the economy." "However, the decree turned out to be a modest redistribution of income in favour of the poor and the less wealthy people rather than a stimulus package. After compensatory tax-raising measures and spending cuts are taken into account, its net effect was less than €1bn."
2.
  - (b) and (g): "The government's main challenges in the next two years are to limit the impact of the global financial crisis on Italy's already weak economy and to prevent the budget deficit from rising too far above 3% of GDP, the ceiling for euro area countries." "[S]ome modest anti-cyclical measures." Suggests that there is a tiny countercyclical expansion. Desire to meet EU rules may be a reason the stimulus was so small.
  - (a): "To bolster confidence in Italian banks, the government has guaranteed deposits up to about €100,000 and allowed banks to negotiate state help in recapitalisation, although no major Italian bank is at present in urgent need of state support." Sounds as if financial rescue is possible, but little money has yet to be spent.
  - (d): "The minister of the economy ... appears determined to keep Italy's public finances under control, fearing that a severe deterioration would lead to a further sharp widening of interest rate spreads on Italy's government debt." Sounds as if market access is a main force.

3. "Italy's government debt burden of over 100% of GDP and a recent sharp widening of the risk premium on Italian government debt have limited the government's ability to intervene to mitigate the impact of the downturn." Suggests that the EIU sees debt as limiting stimulus. "In the event of a collapse of the banking sector (which we think highly unlikely, but which we cannot exclude given the experience of other countries) the Italian state would have less credibility than Germany, France or the UK if it were to intervene in a dramatic way, since public debt is over 100% of GDP. As a result of the increase in global risk aversion, the interest rate spread between Italian ten-year government bonds and their benchmark German equivalent has widened sharply" (from 25 bp to 125 bp).
4. There may be political pressure for tax cuts.

#### **2009M7:**

1. "Despite the limited cost of stimulus measures ..., the fiscal deficit is forecast to rise to 5-5.5% of GDP in 2009-10. The public debt/GDP ratio is expected to be about 120% by the end of 2010." The government is taking a range of measures to mitigate the effects of the recession, but the net cost will only be about 0.1% of projected GDP. Tax cuts promised in the 2008 election have been put on hold.
2. Reference to "fragile public finances." Again, market access seems important (d). "The minister of the economy ... appears determined to keep the public finances under control to avoid a sharp widening of interest rate spreads on government debt." If he were to cut taxes, "borrowing costs could be much higher than we currently forecast for Italy."
3. Very explicit statement that policymakers feel debt is limiting their ability to do fiscal stimulus.
  - "Support for the real economy has been limited by concerns about Italy's large government debt."
  - "Investors in the government bond market appear hesitant but are not shunning Italian government debt." Spreads have come down a bit.
  - "In response to critics who say that the stimulus is insufficient ... the government insists that its room for manoeuvre is limited by Italy's huge public debt." "The government argues that a spending spree would do more harm than good to the economy (by pushing up interest rate spreads on government debt)."
4. "Italy's banks appear less vulnerable than those in the US and other major European countries, given their cautious lending and borrowing strategies, low levels of household debt and high levels of savings. Several major banks have availed of government support to boost their reserve capital, but the sums involved so far have been limited."

#### **2010M1:**

1. "At the end of December the 2010 budget became law. In its final version it contained measures to support the economy worth €11.1bn, about €2bn more than envisaged in early December." "The government has announced that it is looking to introduce another package of stimulus measures worth about €1bn-1.2bn by end-January." Italy is not expected to try to get deficit rapidly down to 3% of GDP.
2.
  - (b): See (1) above.
  - "Mr Tremonti's resistance to pressure to loosen the purse strings seems to have been wise. It has helped Italy to contain interest rate spreads on long-term government bonds and avoid, so far at least, downgrades by the major credit rating agencies." Though there is nothing explicit, market access is implicitly the main driving force (d).
  - Perhaps a bit of (g): "Mr Tremonti is not expected to tighten policy to try to lower the deficit rapidly towards the 3% of GDP ceiling for euro area countries, despite the

European Commission's decision to initiate an excessive-deficit procedure against Italy in October 2009. Italy's Stability and Growth Programme, updated on September 22nd, appears to rely on a pick-up in economic growth to 2% in 2011 to reduce the deficit." Seems to explicitly say they don't care about the EU rules.

3. Italy's high public debt is again mentioned.
4. "One positive factor is that the banking sector has avoided the need for massive public support since the global financial crisis thanks to Italian banks' generally cautious lending and borrowing strategies in the past."

#### **2010M7:**

1. "After rising to 5.3% of GDP in 2009, the fiscal deficit will fall only modestly in 2010 and 2011, owing to the weakness of the economic recovery." The government announced a substantial fiscal contraction; the EIU expects it to be more gradual. "There is a substantial risk that during the outlook period the government will have to implement additional austerity measures if investors become more concerned about Italy's ability to meet its debt-servicing needs."
2. "The government's main challenge will be to try to reduce its deficit and debt to sustainable levels without reversing the fragile economic recovery under way since the end of 2009. This will be made more arduous by the substantial fiscal adjustments being introduced in Italy and most other EU countries in 2010-13 to try to calm financial market concerns about debt levels in the euro zone and elsewhere in the EU." So (d). "The spread of the Greek debt crisis since the end of 2009 forced Italy along with most other countries in the euro area and EU to take action in May 2010 to reduce their budget deficits and government debt burdens in order to prevent a further loss of investor confidence."
3. Debt is expected to stabilize at 120%, but prospects for reduction are low because of slow growth. See (2): suggests that debt is affecting market access.
4. "[D]eeply unpopular 2011-13 budget decree."

#### **2011M1:**

1. Government expects deficit to fall from 5% in 2010 to 2.7% by 2012 because of deficit-reduction measures. EIU is skeptical.
2.
  - Government is trying to reduce spending. "Keeping a firm grip on non-interest spending will be necessary if the Treasury is to continue to meet its debt obligations in 2011 and beyond." Again, market access (d) is implicit, but not explicit.
  - "If the proposed changes to the euro area's Stability and Growth Pact (SGP) are enforced, additional austerity measures will have to be adopted to generate larger primary surpluses of around 3% of GDP to try to reduce the government debt/GDP ratio more rapidly." So (g) could play a role.
3. "The euro area member states most at risk [of sovereign debt problems] are Greece, Ireland, Portugal and Spain. Italy is also at risk given its high level of public debt (an estimated 120% of GDP) and weak economic growth prospects." "The spread on Italian ten-year government bonds over benchmark German equivalents rose from 160-165 basis points in early December 2010 to just over 200 basis points on January 10<sup>th</sup> 2011." "Signs of stress have been more evident in the secondary bond market." Long discussion of why spreads are lower than for other stressed countries.

#### **2011M7:**

1. "The budget deficit will narrow from 4.6% of GDP in 2010 to an average of 4% of GDP in 2011-12. Unless further austerity measures are introduced in 2013-14, it will rise again as

a result of an expected rise in debt-servicing costs.” “Although approved by cabinet at the end of June 2011, the proposed austerity measures worth a total of €40bn in 2013-14 are not yet factored into our forecasts.”

- Definitely taking some austerity measures: frozen public-sector wages and across-the-board cuts in ministerial budgets and sharp reductions in transfers to local administrations.
  - “At the end of June the minister of the economy, Giulio Tremonti, announced further austerity measures (on top of those enacted in 2010) worth a total of €47bn: €1.5bn (US\$2.1bn) in 2011; €5.5bn in 2012 and €20bn a year in 2013-14.”
2.
    - “Failure by the government to implement fully the austerity measures introduced for 2011-12 and adopt the additional measures promised in 2013-14 might result in much higher spreads on Italian long-term government bonds over benchmark ten-year German equivalents.” The EIU clearly thinks that market access (d) is a motivation.
    - Not doing more tightening because it could send the economy back into recession. “With economic growth looking anaemic, further fiscal tightening in 2011 and 2012 could have sent the economy back into recession.” Could suggest that countercyclical concerns (b) are a reason austerity is not bigger.
  3. Spread rose briefly over concerns that Greece might be headed to a disorderly sovereign default. Moody’s “placed Italy’s Aa2 sovereign debt rating on review for possible downgrade, citing the country’s weak growth prospects, fiscal consolidation implementation risks, rising interest rates and deteriorating funding conditions in Europe generally.”

#### **2012M1:**

1. EIU forecasting that budget deficit will fall from 4% of GDP in 2011 to 1% in 2013. “[F]iscal austerity at home.” Decree law aims to reduce budget deficit by €20bn in net terms. Taking actions to try to get deficit down to zero in 2013. Raising taxes and pension reform.
2.
  - Prime Minister Monti has emphasized growth-spurring reforms as well as improvement in public finances. He has won a large majority in favor of further fiscal austerity. Market access seems main reason (d): “It was hoped that Mr Monti’s appointment and policy initiatives would restore financial market confidence, but so far investors have continued to demand high interest rates on Italian government debt.”
  - Perhaps a bit of EU rules/pressure (g): “The agreement reached at the EU summit on December 8<sup>th</sup>-9<sup>th</sup> to increase fiscal discipline amongst all euro zone countries and bring the ESM forward to 2012 provided little reassurance.”
3. “Italy is in a state of acute financial and economic crisis which threatens its position in the euro zone, and even the euro zone itself. This results primarily from a change in market perception of the state of its public finances. Attention has focused on the fact that Italy’s public debt is the largest in absolute terms in the EU and the second largest after Greece’s relative to GDP.”
4. EIU worried about political instability. New technocratic government.

#### **2012M7:**

1. Government’s revised target is to eliminate the fiscal deficit by 2014 rather than 2013. Taking more austerity actions. “[C]abinet approved spending cuts worth €26bn to be

introduced between mid-2012 and the end of 2014. Implementation will be challenging, but should avoid further increases in the tax burden in 2012.”

2. “Mr Monti has been prominent in the EU debate on the need for a pro-growth strategy to counterbalance fiscal austerity as well as collective measures aimed at breaking the vicious circle between struggling banks and sovereigns.” This could suggest that countercyclical purposes (b) are playing a role in limiting austerity. But, Italy is continuing to take austerity. EIU thinks it is related to market access (d): “With public debt at 120% of GDP, the largest in absolute terms in the EU and 23% of the euro area total, and economic growth prospects poor, Italy will remain vulnerable to shifts in investor sentiment if its commitment to fiscal consolidation and liberalisation is seen to be waning.”
3. “Pressure on Italian government debt yields remains strong as the euro area sovereign debt crisis has intensified since March 2012 over uncertainty about Greece’s survival in the euro area and the spillover of the banking crisis to the sovereign in Spain.”
4. Continued concern over political instability. “An early collapse of the Monti government would further damage investors’ confidence in Italy’s ability to tackle its deep economic and financial problems. As a result, investors, who are already concerned about the direction of policymaking after the next general election, could flee Italian government debt.”

**Bottom Line: Italy engaged in only trivial fiscal stimulus and little financial rescue in the post-crisis period. This was followed by moderate austerity for a number of years. A key reason for the austerity was problems with market access and rising sovereign spreads. EU rules and pressure were another factor.**

## **NORWAY (2008:2)**

### **2008M7 (pre-crisis):**

1. Expansionary. No explicit discussion of size, but it doesn't seem large.
2. (i): The government is flush with oil revenues, and is using them to pursue long-term objectives: "Over the next two years public spending on local government, health, education, research and environmental projects will increase as the government channels an increasing amount of oil wealth into the economy."
3. No.

### **2009M1:**

1. Expansionary. Seems small: projected swing in the non-oil deficit is only 0.7% of GDP. But additional measures are likely.
2. (b) and (i) (still flush with oil revenues), and perhaps some (a).
  - Basics ((b) and (i)): "The government's short-term economic policy priority will be to manage the fall-out from the global financial crisis and the looming economic slowdown. ... The government's 2009 budget promises to use petroleum receipts to deliver a fiscal stimulus through increases in both current and capital spending, ... as well as additional funds to raise employment in local government services. The government is due to announce an additional stimulus package at the end of January."
  - Perhaps (a): There's mention of actions to help the financial system, but it's not clear if the actions are fiscal: "The authorities have undertaken a number of measures designed to reduce risk premiums in the money markets and improve banks' access to funding, although Norway's financial sector has so far not been as hard hit as in some European countries." The July 2009 and July 2010 reports say more.
3. No.
4.
  - Significant banking problems.
  - An unusual fiscal action: government contributed to rescue packages for Iceland and Latvia. (Probably in part a form of financial rescue, since Norwegian banks would be affected by troubles in those countries. Amount seems small.)
  - Oil prices are way down.
  - Oil revenues help facilitate expansion (but oil wealth not mentioned): "The government's 2009 budget promises to use petroleum receipts to deliver a fiscal stimulus."

### **2009M7:**

1. Expansionary. Described as "the most expansive budget since the 1980s" and "a substantial fiscal stimulus (worth around 3% of mainland GDP)." Also say that the structural non-oil budget balance has swung by 3% of mainland GDP, which fits with this.
2. (b) and perhaps some (a). (b): "The government's short-term economic policy priority is to manage the impact of the global economic and financial crisis"; "a substantial fiscal stimulus." Perhaps some (a) (though this sounds like a fuller explanation of previous actions, not new actions): "the authorities have undertaken a number of measures designed to reduce risk premiums in the money markets and improve access to funding. This includes the creation of two state funds, one to boost banks' Tier 1 capital if they request help and another to buy company bonds." The fact that the July 2010 report describes the actions as having been liquidity provision suggests that there were not in fact capital injections.

3. No.
4.
  - Oil makes it easier to pursue expansionary policy: “the government has used its ample fiscal resources to deliver the most expansive budget since the 1980s”; “The 2009 budget draws on petroleum receipts to deliver a substantial fiscal stimulus.” First quote is unclear about whether it’s the stock of wealth or the flow of revenues that’s relevant; the second one points to the flow.
  - “Other reforms aim to promote long-term fiscal sustainability and economic development. A reform of the pension system, originally planned for 2010, has been postponed by one year.” (One implication is that the references to this reform in later reports are not new austerity measures.)

**2010M1:**

1. Expansionary, but less so than before (some stimulus being phased out).
2. (b). Basic stance is expansionary, but the economy is starting to recover, so less stimulus is needed. “The government’s short-term economic policy priority is to ensure a sustainable economic recovery from the global economic and financial crisis by using petroleum receipts to maintain an expansionary fiscal policy. The 2010 budget phases out subsidies for local government infrastructure spending, but continues most other stimulus measures introduced in 2009.”
3. Say that oil wealth has facilitated fiscal expansion: “the government has drawn heavily on the state’s petroleum wealth to cover the costs of the recession.” Also say that Norway’s fiscal rules will require the government to reduce the non-oil deficit going forward.
4. Economy is growing.

**2010M7:**

1. Expansionary (no real information, except saying that the 2009 and 2010 budgets are expansionary, but this isn’t new to this report).
2. (b). EIU says very little about motivation beyond, “The government will continue ... supporting employment.” Given this, the broad motivation is presumably the same as before.
3. Say that Norway’s fiscal rules will require the government to reduce the non-oil deficit going forward.
4. Describes earlier actions to help the banking system as having been liquidity provision: “In the wake of the crisis, the authorities provided liquidity support to Norway’s banks, which has now been scaled back, and solvency problems have been largely absent.”

**2011M1:**

1. Slightly less expansionary than before: “a modest tightening of fiscal policy (0.2% of mainland trend GDP).”
2. Unclear. Really no discussion. Perhaps (h) (economy is recovering, so less stimulus than before). Continue to say (twice), “The government will continue ... supporting employment,” suggesting no sharp change in policy.
3.
  - Say that Norway’s fiscal rules will require the government to reduce spending going forward. (Previous two reports refer to reducing both spending and the non-oil deficit, but here they only say spending. But the rule seems to in fact be in terms of the non-oil deficit.)
  - Oil wealth facilitated expansion: “Norway’s substantial sovereign oil wealth will

- continue to provide a buffer to cushion the economy in times of distress without creating either an external payments imbalance or the budget deficit and debt problems now prevalent in other countries” (emphasis added).*
4. Economy is recovering. EIU expects 2% growth going forward.

**2011M7:**

1. A hair less expansionary than before: “a moderate fiscal tightening of 0.3% of mainland trend GDP” (this seems to be about the effect of policy changes, not endogenous behavior of the deficit).
2. Unclear. Really no discussion. Perhaps (h) (economy is recovering, so less stimulus than before). EIU still says, “The government will continue ... supporting employment.”
3.
  - Comment about the implications of Norway’s fiscal rules is no longer included (because of higher oil prices, it appears).
  - Say that not reducing the structural non-oil deficit would have harmful effects via interest rates and the exchange rate. (At least the two previous reports have similar language.)
  - “Norway’s substantial sovereign oil wealth will continue to provide a buffer to cushion the economy in times of distress without creating either an external payments imbalance or the budget deficit and debt problems now prevalent in other countries.”
4. Relevant parts are extremely similar to previous report.

**2012M1:**

1. Neutral: no change to 2011 budget, and “[t]he impact of the 2012 budget on mainland GDP is estimated to be broadly neutral.”
2. Unclear. Really no discussion. Previous reports and the hypothetical below about how they would respond to a recession point slightly to (b).
3. Same language as before about harms of not reducing the non-oil deficit and the buffer provided by oil wealth.
4.
  - “In focus: Weaker global outlook could lead to expansionary fiscal policy ... Norway’s substantial sovereign oil wealth would allow the government to pursue a more expansionary fiscal policy.” (Hypothetical, not about actual policy.)
  - Economy is weaker, but EIU views that as temporary.
  - “In December 2011, Norway suffered a butter shortage.” 

**2012M7:**

1. “[T]he budget is slightly expansionary.”
2. Unclear. Really no discussion. “The government’s centrist programme focuses on supporting employment”; “In its slightly expansionary budget for 2012 .... The 2012 budget should comply with the ‘fiscal rule’, which permits a structural non-oil deficit of up to 4% of the value of Norway’s sovereign wealth fund”; “Although the budget is slightly expansionary, the government will be wary of accelerating economic growth .... High revenue will, however, allow the government to expand spending slightly more later in the forecast period.” The concern about employment points to (b)—but the unemployment rate is 3%. So, perhaps some (b) and some higher oil revenues (i)?
3. Language about harms of not reducing the non-oil deficit and the buffer provided by oil wealth appears to be gone.
4. GDP growth expected to recover; unemployment is down to 3%.

**Bottom Line: Policymakers in Norway undertook moderate fiscal expansion in response to the crisis, motivated by both countercyclical aims and financial rescue. The EIU thought Norway's oil revenues and low debt were reasons it could do this. The government then scaled back the stimulus in response to recovery to prevent the economy from overheating, but it never switched to net austerity.**

## **PORTUGAL (2008:2)**

### **2008M7 (pre-crisis):**

1. "Fiscal policy is expected to remain tight in 2008-09, but there could be spending overruns, as the government's reform of the public administration is likely to see further delays because of trade union and civil service resistance." "The Economist Intelligence Unit expects the government to bring down the general government deficit only slightly further in 2008-09, following a sharp fall in recent years from 6.1% of GDP in 2005 to 2.7% in 2007."
2. (g): "The government has been successful in reducing the budget deficit, which fell to 2.7% of GDP in 2007, down from a high of 6.1% of GDP in 2005. This brought it below the 3% of GDP limit outlined in the EU's Stability and Growth Pact, one year ahead of the target originally specified by the excessive-deficit procedure, which will now be closed."
3. Nothing of note in this issue.
4. "On June 26th the OECD issued a new economic survey of Portugal. The organisation praised Portugal for the progress achieved in fiscal consolidation and the launch of structural reforms. However, it also cautioned that Portugal is not closing the large income gap with the most developed nations, as a result of (among other factors) an insufficient GDP growth rate. The OECD emphasised the need to secure the results achieved in fiscal consolidation, namely through a full implementation of public administration and health reforms, as well as by improving the performance of state-owned companies." Large fall in stock prices.

### **2009M1:**

1. "Earlier fiscal consolidation efforts by the government are likely to be reversed in 2009-10 by a slowing economy. We expect the budget deficit to rise to 4-5% of GDP in 2009 and 2010." "The government has unveiled new stimulus measures to support key economic sectors." "The sum of all the financial aid in various forms amounts to almost €30bn and is especially focused on the financial sector."
2. (b) (mainly), (a) and (c): "Leading up to the general election, expected in June or October 2009, the government will be preoccupied with efforts to alleviate the impact of the forecast severe recession on Portuguese workers and companies. It has already implemented measures to guarantee bank lending and nationalised a small bank." "The 2009 budget marked a break from the previous fiscal consolidation efforts, partly as a result of the economic slowdown, but also in light of the upcoming general election."
3. "The government has previously been successful in reducing the budget deficit, which fell to 2.6% of GDP in 2007, down from 6% of GDP in 2005, allowing Portugal to be removed from the EU's excessive-deficit procedure."
4. Ongoing banking problems. Substantial spending on banks.

### **2009M7:**

1. Expansionary, may turn less so depending on outcome of the election; "Spending on economic stimulus is expected to be mild in Portugal, especially as public investment projects that were meant to be part of this effort have stalled." "Earlier fiscal consolidation efforts by the government will be reversed in 2009-10."
2.
  - (b) and (c), with just a touch of (a): "In 2009 Portugal faces the twin challenges of a severe economic recession and a closely fought election cycle. Before and after the election, respective governments are expected to focus on alleviating the effects of the recession." "After the general election in September 2009, policy trends will depend on both the result of the election and the party alignment that follows. Either a PS- or

- PSD-led minority government would be likely to prioritise fiscal deficit reduction.”  
 “Any post-election government will also be preoccupied with efforts to alleviate the impact of the severe recession. It will also have to continue to be prepared to help out ailing banks, although in this respect, Portugal has had to intervene less than many other west European countries.”
- Perhaps a bit of (g): “The European Commission has announced that it will open an excessive-deficit procedure against Portugal and seven other EU countries in November 2009.”
3. “The forecast deficits do not imply that the public finances are unmanageable, but difficult decisions to cut the deficit will be required in due course.”
  4. Closely fought election cycle.

### **2010M1:**

1. Slightly expansionary. “New spending on economic stimulus is expected to be mild.” “The deficit is forecast to fall from an estimated 8.1% of GDP in 2009 to 5.9% of GDP by 2011.”
2.
  - (b): “The government’s main objectives will be constrained by its need to foster economic and employment growth and to cut the budget deficit.” “The PS minority government’s programme emphasises the need to foster economic and employment growth (following a severe recession). However, in practice, it will also need to prioritise fiscal deficit reduction, given the recent steep rise in the deficit, and expenditure plans will be constrained.” “It will have to continue to be prepared to help out ailing banks, although in this respect, Portugal has had to intervene less than many other west European countries.”
  - “The EU has already launched an excessive-deficit procedure against Portugal for 2009, but, unlike in earlier years, most EU countries are facing the same scrutiny.” So, there may be a bit of (g), but it doesn’t seem like a serious factor.
3. EIU clearly thinks deficit is a problem. Thinks government will take measures to deal with it. “A key risk to fiscal consolidation stems from the risk of borrowing costs spiralling out of control. At present, Portugal can fund its debt issuance at a reasonable cost, but if long-term interest rates rise, perhaps owing to market contagion over fiscal fears in other euro area countries, the increase in debt-servicing costs could overwhelm other efforts to reduce the deficit.” S&P “has put Portuguese state debt on a negative outlook, over concerns about fiscal sustainability.” “The government’s first budget of its new term will be important for setting out a strategy for deficit (and debt) reduction, but the public finances seem to be manageable at present.”
4. “Government is still adjusting to loss of absolute majority,” but, “the expected negotiation with centre-right parties should be beneficial to fiscal consolidation.”

### **2010M7:**

1. Harsh austerity. “[T]he accelerated fiscal austerity plan.” “The sovereign debt crisis in peripheral euro area countries is forcing the government to engage in rapid and significant public spending cuts.”
2.
  - (d): “The Socialist Party (PS) government faces a major challenge to reduce the budget deficit, under severe pressure from financial markets.” Its minority status will make this process more fraught than in the past.” “The sense of national crisis over the deficit should support this process.” “The government has since been forced to accelerate the fiscal tightening process, as financial markets balked at the slow pace of consolidation.”

- "The European Commission has asked Portugal to find additional ways to cut its public expenditure in 2011, in order to complement further the tax increases already agreed." Could indicate that (g) is a factor; some conditionality stemming from usual EU agreements.
- 3. "We expect Portuguese government debt to reach 95% of GDP at end-2012 and remain on a rising trend." EIU thinks Portugal will have to go to the EU/IMF facility.
- 4. Borrowing costs are high.

**2011M1:**

1. Austerity; tax increases and spending cuts.
2.
  - (d): "sovereign bond markets have increasingly lost confidence in the government's budget deficit reduction efforts and financing the deficit has become too expensive."
  - "The minority PS government has been facing an immense task in any case to reduce the budget deficit from 9.4% of GDP in 2009 to 3% of GDP by 2013, as agreed with the European Commission." So, may be a role for (g).
3. "Portugal is forecast to access the joint EU/IMF emergency credit facility in the first half of 2011." Accessing the facility will come with strict conditionality. "There is a high risk that Portugal will not be able to service its public debt in the medium to long term." "Portugal has been edging closer to a bailout from the joint EU/IMF emergency credit facility, having been able to raise public debt on international financial markets only at expensive rates that are unsustainable in the medium term." "Portuguese public debt is expected to rise rapidly for some years and eventually to stabilise at around 100% of GDP."
4. Heightened political instability.

**2011M7:**

1. Harsh austerity. "A bail-out from the joint EU/IMF emergency credit facility will entail strict fiscal consolidation and deep-reaching structural reforms of the economy." "[B]udget deficit targets of 5.9% of GDP in 2011, 4.5% in 2012 and 3% in 2013, to stabilise public debt by 2013." "The public finances recorded a deficit of 9.2% of GDP in 2010."
2. (e): Portugal signed an agreement with the EU/IMF facility in May. Strict conditionality. "Economic and fiscal policy will be defined by the bail-out agreement with the EU and the IMF, with the government having little say over policy." "The bail-out ... will depend on implementation of a severe fiscal squeeze, in order to reduce the government's budget deficit to below 3% of GDP and beyond." "The government also gives explicit precedence to the objectives set in the MoU over any other policy in the fiscal area."
3. Deficit is seen as a problem because it caused loss of access to funding. "[W]e expect further financing from the troika to be necessary during 2014-15, as the public finances will still be in deficit at this point, and Portugal will not be considered creditworthy enough to return to commercial funding markets."
4. "Portugal faces political and economic upheaval in 2011-15."

**2012M1:**

1. Harsh austerity: "strict fiscal deficit reduction programme in 2011-13."
2.
  - (e): "Portugal faces severe economic upheaval in the forecast period. Its bail-out from the EU/IMF emergency credit facility entails severe fiscal consolidation and deep-reaching structural reforms, which could threaten political stability." "Economic and fiscal policy will be defined by the bail-out agreement with the EU and the IMF, with

the government having little say over policy.” “[I]nternational creditors are likely to be inflexible in their demands for further austerity in return for continued deficit and debt funding.” “Portugal is likely to require additional financial support, involving further tough conditionality.”

- Reference to fact that deficit might be lower than that contained in the MoU. Could suggest an element of own ideas (f). “The government intends to cut the fiscal deficit faster than the already aggressive path intended by the bail-out programme.”
- 3. “We expect further official financing to be necessary in 2014-16, as Portugal will not be considered creditworthy enough to return to commercial funding markets.”
- 4. Mention that credit remains tight and banking system is weak.

#### **2012M7:**

1. Deficit rose a bit in 2012Q1 (7.9% from 7.5% a year earlier). Bailout agreement calls for strict deficit reduction, but has met with only limited success so far. Rise in deficit due to falling tax revenue and falling GDP.
2. “We expect the government to try to stick to the programme (given the dire alternative of a disorderly default on public debt), but a risk remains that disagreements within the coalition lead to a deeper crisis.” So market access and conditionality remain important ((d) and (e)). “The government’s economic policy plans hew closely to the conditions imposed by the EU/IMF/ECB bail-out programme.”
3. Public debt will rise from 108% of GDP at the end of 2011 to above 130% by the second half of the forecast period, “which we believe is too high for Portugal to sustain.” EIU is expecting debt restructuring.
4. “The economy is expected to be extremely weak, weighed down by the effect of severe fiscal consolidation on all components of domestic demand.” Troika evaluation is relatively upbeat.

**Bottom Line: Portugal initially engaged in mildly expansionary policy for countercyclical purposes (with just a small amount of financial rescue). Political considerations in the run-up to the election also played a role in driving fiscal expansion. EU rules and actions were a factor in the early moves toward austerity. Starting in mid-2010, Portugal lost the confidence of foreign investors. Lack of market access followed by IMF conditionality led to extreme austerity. The austerity and conditionality continued through the end of the analysis period.**

## **SPAIN (2008:2)**

### **2008M7 (pre-crisis):**

1. Expansionary.
2. (b): “the government is pursuing a strongly expansionary fiscal policy”; “The government’s slew of measures to cushion the economic downturn”; etc. The one number the EIU gives is about 1% of GDP, but that may not count everything. Also:
  - The response is tempered by concern about the deficit/debt (f). However, that changes once the crisis starts (next report).
  - There’s one discussion of potential problems in financing the current account deficit (but not the government budget deficit).
  - There’s one reference to the 3% SGP limit (g) as a potential issue, but no sense that it’s affecting policy.
3. “[A] sharp economic slowdown”; “credit crisis.”

### **2009M1:**

1. Expansionary. The two main measures described by the EIU seem to sum to about 2% of GDP. There is also up to 15% of GDP for the banking sector, but the EIU only mentions it once and does not break it into guarantees, capital injections, etc. The next report says that the measures are “largely in the form of loan guarantees and purchases of illiquid bank assets.”
2. (a) and (b). “The government is pursuing a strongly expansionary fiscal policy, ... focusing largely on responding to the economic downturn and the international credit squeeze. In 2008 the government approved successive packages of measures .... It also announced the creation of a major support programme for its banks ..., at a theoretical cost of €150bn (equivalent to around 15% of GDP).” The next report says that this was “largely in the form of loan guarantees and purchases of illiquid bank assets.” And, “In part, the government’s efforts to counteract the economic downturn have been focused on reviving dysfunctional credit markets and averting an implosion of the banking sector.”
3. EIU discusses the debt, sees major potential budget problems and a potential crisis, and discusses SGP rules. However, with one exception, they indicate that these are not affecting policy. Moreover, they say policy is no longer being constrained by deficits/debt.
  - Policy has changed, and the problems the EIU sees are not affecting policy: “the prime minister, Mr Zapatero (PSOE), ... appears to have jettisoned the more passive conservatism that has characterised the tenure of economics minister, Pedro Solbes. Policy has become more proactive and expansionary, with Mr Zapatero appearing ready to throw caution to the wind in his readiness to tackle the unfolding economic crisis”; “The message being conveyed is that the government will pull out all the stops to cushion the impact of the economic downturn”; and more.
  - The exception: “the government’s capacity to make a direct contribution to aggregate demand, in the form of public consumption and investment, will be constrained by the slump in tax revenue and soaring unemployment benefit costs.”
  - Discussion of budget problems, possible budget crisis, and SGP rules: “The Spanish public finances are at risk of heading into a state of crisis.” “With the deficit expected to be more than double the SGP’s 3% ceiling in 2009-10, the government risks the European Commission starting an excessive-deficit procedure against it” (but note that they are not saying this is currently affecting policy). “Spain could also face difficulties in raising finance in 2009-10.” And more. Also, “Public debt is expected to rise from an estimated 39.2% of GDP in 2008 to 59.9% in 2010.”

4. “[S]evere economic downturn”; “credit crisis.” Also, despite the fact that the initial financial rescue makes up to 15% of GDP available (which seems huge), at the end of the window we look at, Spain is turning to the EU for help with its banks. So, one wonders if the financial rescue was less aggressive than indicated here.

### **2009M7:**

1. Expansionary for now, but there are plans for austerity.
2.
  - On the expansionary side, (b) and (a). “Economic policy will focus on stemming the recession”; and, “The government is pursuing a strongly expansionary fiscal policy in 2009, ... focusing largely on responding to the severe recession and the global credit squeeze.” With the exception of a new program to help banks (“In late June the government finally approved the creation of a new public entity, the Fund for Ordered Bank Restructuring (FROB), to deal with troubled banks .... The fund will receive €9bn in capital [slightly less than 1% of GDP]”), there don’t appear to be new expansionary policies since the last report (though there may be—for example, there’s a reference to “another expansionary budget”).
  - On the contractionary side, (d), probably (f), and a small amount of (g). (d): “Yield spreads on government bonds widened in early 2009, raising debt-servicing costs”; “Spain could ... face difficulties raising finance in 2009-10.” (f): There’s a general sense (not just from the EIU, but from policymakers) that the high deficits require austerity, without a clear view of why: “the government is now ruling out further stimulus measures, recognising the need for restraint given the prognosis for the public finances in the medium term”; “it is now widely accepted that tax rates will have to be increased”; “The governor of the Bank of Spain ... [recognizes] the need to prepare a credible exit strategy” from fiscal expansion; and more. (g): There’s one minor reference to SGP rules: “bringing the public finances back into line with the guidelines established by the EU’s Stability and Growth Pact (SGP).”
3. One discussion of the level of debt: “We forecast that public debt will rise from an estimated 40.3% of GDP in 2008 to 74.8% of GDP at end-2010.”
4. “[D]eep recession”; “The freefall in economic activity appears to be slowing.”

### **2010M1:**

1. Contractionary. Size of the desired contraction is about 3% of GDP: the Minister of the Economy estimates that 3 percentage points of the desired swing in the deficit-to-GDP ratio “will be achieved ... through structural budget reforms.” So far, the central government is cutting its spending by 3.9%, and pursuing tax increases of 1% of GDP. And, “the government will have little choice but to pursue a sharply austere budget in 2011.”
2. (d), and perhaps some (f).
  - (d): Concern over market access, which is affecting policy. “[T]here is concern over the financing of future deficits. ... [I]nvestor concerns over Spain’s ability to meet its debt obligations could see it face funding difficulties and/or higher long-term interest rates”; “In early December 2009, Standard & Poor’s ... revised its outlook for Spanish sovereign debt from stable to negative, unnerving both financial investors and policymakers. ... The government responded by reaffirming its commitment to reduce the general government deficit to below 3% of GDP by 2012, down from just over 10% of GDP in 2009” (which is a lot!).
  - Perhaps some (f): The EIU may have a broader sense that the high deficits require austerity: “the poor state of the public finances has forced the government to take measures in the 2010 budget to stem their deterioration”; “Given the further

- deterioration of the budget balance in 2010, the government will have little choice but to pursue a sharply austere budget in 2011”; and more.
3. No mention of SGP rules (though one discussion—above—of getting deficit below 3% of GDP). One discussion of debt-to-GDP ratio: “We forecast that public debt will rise from an estimated 56.2% of GDP in 2009 to 80.2% of GDP at end-2011.”
  4. GDP may be bottoming out, but, “The economic downturn in Spain will be longer in comparison with most EU member states.”

#### **2010M7:**

1. Very contractionary. New measures (“the approval by decree on May 20th of a severe fiscal retrenchment” of 1.5% of GDP); more ambitious goals (“the government ... is now promising a quicker decline in the general government budget than previously forecast”); and “the government is expected to pursue a sharply austere budget in 2011.”
2. EIU overwhelmingly emphasizes (d) (though perhaps there’s some broader sense that the deficit and debt are a problem and need to be addressed, and thus some role for (f)). “Policy will focus on facilitating an economic recovery, improving the public finances and reassuring investors.” “With events in the financial markets in April and early May forcing its hand, the new austerity measures.” “Partly in response to the austerity measures and other recent policy initiatives, investor sentiment towards Spain appeared to have settled somewhat by early July. Nonetheless, concerns about the underlying deficit and debt dynamics remain acute.” “[T]he yield differential with Germany has settled at around 200 basis points or above.” “Rumours abounded in early June that Spain, in the face of severe financing difficulties, was preparing to tap the recently established EU-IMF €750bn stabilisation fund.” And more. An example of a broader view: “high deficits and rapidly rising debt call for drastic action.”
3. One discussion of the European Commission, but it gets little emphasis: “In mid-June the European Commission positively evaluated the restrictive fiscal policy measures approved in the government’s May 20th decree. ... However, the European Commission called on the government to implement an additional adjustment of €15bn [roughly 1% of GDP] to meet the 2011 target of 6%.” There are various mentions of possible IMF/EU lending, but no sense that this is affecting policy. Some discussion of debt/GDP. For example, “We forecast that public debt will rise from 53.2% of GDP at the end of 2009 to 72.3% of GDP at end-2011.”
4. “[E]uro zone sovereign debt crisis.” EIU raises the possibility of “a substantial write-down of its public debt,” though it says this “does not look likely.”

#### **2011M1:**

1. Contractionary (including new measures).
2. (d), with some possible role for (g) and/or (e). (No evidence in this report for (f).)
  - (d): “The Spanish government (and central bank) has redoubled its efforts to assuage investor concerns over Spain, announcing a flurry of new measures, including fiscal consolidation”; “implementing reforms that alleviate investor fears”; “The widely watched differential between yields on German and Spanish ten-year bonds ... have since resumed their rise”; “the fragility of market sentiment was shown on December 14th, when Moody’s, a credit ratings agency, announced that it was putting Spain’s sovereign credit rating under review for a possible downgrade.”; and more.
  - (g) and/or (e) and/or (i): This is less prominent than investor confidence. The main discussion is, “Under intense pressure by the EU to restore fiscal order ... and to reinstil investor confidence, the government announced a harsh fiscal retrenchment .... [The deficit] will narrowly miss the level of 3% by 2013 that the government is promising as per its Stability Programme for 2009-13. ... [S]hould financial markets

lose confidence in the sustainability of Spain's public finances, the country would need to ... make use of the European Financial Stability Facility (EFSF, the euro area bail-out fund) .... [A]ny loan agreement for Spain would be conditional on further fiscal austerity measures." Unfortunately, the EIU does not explain the nature of the EU pressure or how it's affecting policy. There seem to be 4 possibilities, with the truth likely being a mix:

- It presumably has some element of (g) (usual SGP limits), but there's clearly more to it than that.
  - The discussion of EU pressure is paired with the need "to reinstil investor confidence," so it could partly be operating via (d)—the EU insisting forcefully that austerity is needed because of problems with market access. One piece of evidence that players outside Spain are more concerned about market access than Spanish policymakers are, and thus that (d) may be part of the EU pressure, is that "doubts about the political sustainability of a harshly restrictive fiscal policy ... are being voiced ever more loudly by international financial institutions and the media, raising fears that the crisis may be developing into a self-fulfilling dynamic," and that Spanish policymakers are trying to push back against that.
  - It could have an element of (e)—conditionality, or in this case, prospective conditionality: one could read into the fact Spain may need to turn to the EFSF, and that doing so would come with requirements of even greater austerity, that some of the austerity so far is to stay on the EU's good side so that the EFSF would be available if needed. But, the EIU does not say this.
  - A final possibility is that the EU is pressuring Spain because if Spain got into trouble, that could have catastrophic consequences for all of Europe. Pursuing austerity to avoid that would be a choice. It would be based on an idea, but a very different one from usual. The most relevant passage is: "If Spain were to need a rescue, attention would probably turn to Italy ..., which would mean that so much of the euro area would be affected that it could no longer be considered a peripheral problem. Funds so far made available would probably not be sufficient to cover Spain's needs through to 2013, let alone those of Italy. ... [T]he future of the euro zone would be seriously questioned."
3. There are various discussions of debt/GDP.
  4. Continuing euro area sovereign debt crisis; weak recovery; continued fears about the health of banks.

#### **2011M7:**

1. Austerity (basically a continuation of previous policies).
2. (d), and some (g), (e), and/or (i). The overall tone and many of the specifics of this report are very similar to the previous one. There's some sense that the fiscal outlook is improving; perhaps as a result, there's somewhat less discussion of investor confidence. And the discussion of risks to the euro zone is gone, suggesting less evidence for (i).
3. Again, all similar to previous report. (One modest change is that there's more discussion of fiscal problems at the regional and local level.)

#### **2012M1:**

1. Austerity (including new measures).
2. (d), and some (g), (e), and/or (i). Also, the new government seems more committed to austerity than the previous one, perhaps suggesting some role for ideas (f).
  - (d), and some (g), (e), and/or (i): Statements are similar to the previous two reports. "[W]ere investors to take fright and force yields higher than is currently forecast. This risk was highlighted when bond yields rose above 6% in mid-July and early

August 2011.” “With Spain set to remain a focus of investor concern.” “Should financial markets lose confidence in the sustainability of Spain’s public finances.” “Under intense pressure from the EU and financial markets to restore fiscal order, both the previous and the new government have announced harsh fiscal measures. The new PP government announced that the 2011 budget deficit was far higher than previously expected .... [T]he PP has announced it would focus mainly on reducing deficits. A gradual improvement in the general government budget is expected, although the target of 3% by 2013 under the government’s Stability Programme for 2011-14 seems almost certain to be missed. External pressure for additional austerity is likely to grow.” “Although not our central forecast, there is a high risk that contagion from the euro area crisis will force Spain to access the European Financial Stability Facility (EFSF), necessitating further fiscal austerity measures.” One change is that the discussion of possible break-up of the euro has reappeared. The main discussion is in the context of the possibility of “disorderly default” by one or more countries, not aid to Spanish banks. But, concern about Spanish and Italian bond yields “implies a continued need for ‘reluctant’ ECB intervention to keep yields at manageable levels, if a wave of debt defaults and the break-up of the euro zone are to be avoided.”

- (f): For example, “The new PP government has placed considerable emphasis on implementing a wide-ranging structural reform programme and austerity drive.” But the policies don’t seem qualitatively different than before, and the additional measures are partly due to the fact that the deficit is higher than projected.
3. EIU discusses debt/GDP and its projected upward path.
  4. New government; falling GDP.

#### **2012M7:**

1. Austerity.
2. (d) and perhaps some (e) (and possibly some (i)), plus (a) in the other direction. “Under intense pressure from the EU and financial markets to restore fiscal order, the government has begun implementing a wide-ranging fiscal adjustment programme of about €37bn in 2012. ... Budgets for the following years will remain restrictive.” Relative to previous: (1) EIU is more focused on high bond yields, and more emphatic that investors are scared and Spain is having trouble with market access. For example, in a report on 6/29, they describe Spain as “all but priced out of the market,” and on 6/17, they say, “Market funding has become unaffordable for Spain.” (2) There’s continued discussion of extremely high interest rates and possible connections with problems in the rest of the euro area, so still some evidence for (i). (3) Importantly, Spain is in the process of getting EU help for its banks: “the situation of the Spanish banking sector forced the country to access emergency financial support from its euro zone partners” (though the specifics are still in progress) (so, (a): there is recapitalization, including discussion of injections from the entity discussed in the 2009M7 report). This does not come with any new austerity requirements (“To qualify, countries must abide by EU budget rules, but no additional, Greek-style, austerity measures will be imposed,” and, “No additional budget cuts have been imposed on the country in return for the debt”), and it’s lowering bond yields. But it makes the conditionality that had been at most prospective or implicit now perhaps explicit. (And it means that the EU pressure is now clearly more in the category of (e) than (g).) (Note that some of what’s listed under (1) and (2) in this paragraph precedes the agreement for EU help.)
3. The usual. (One thing the EIU notes in this report and in earlier ones, and says here that Spanish policymakers try to emphasize, is that debt/GDP isn’t wildly high or projected to become so.)

4. Severe recession.

**Bottom Line:** Spain initially engaged in mildly expansionary fiscal policy for countercyclical reasons and financial rescue. But policy then turned strongly contractionary and remained so. The main reason was market access, as Spain faced high sovereign spreads and ratings downgrades. Toward the end of the period, the problems with market access led to the possibility of Spain needing to turn to outside help, which created additional pressures for austerity. There were some indications of a role for domestic policymakers' ideas, but those were never central.

**SWEDEN (2008:2)****2008M7 (pre-crisis):**

1. Slightly expansionary. The only thing that's clearly new is, "In June the government announced a cut in taxes for pensioners on low incomes," which sounds small. Also, "Wealth tax has been abolished and some other taxes reduced," but this is in the context of a discussion of policy since 2006.
2. (f)? Government ideology is supply-side: cut taxes, improve incentives to work, etc. Also, there's a surplus and debt/GDP is low. These seem to be the motivations for the tax cuts.
3. Discuss debt/GDP (low) and its projected path (downward). Say public finances are healthy.
4. Economy is slowing but has not been greatly affected by world financial troubles.

**2009M1:**

1. Expansionary. The only number given for conventional fiscal stimulus is slightly less than 1% of one year's GDP, spread over 3 years. But there are also recently announced tax cuts (see below), of unspecified size. The EIU cites them but not the higher spending as a reason for the higher deficit, suggesting that they are larger than the spending increases.
2. Mainly (b), also (a) (plus bailing out auto companies, mainly through loan guarantees). "The government is pursuing an expansive fiscal policy and in the short term it will focus on responding to the economic slowdown during 2009-10. The government will introduce cuts in personal taxes, corporate taxes and employers' social security contributions, as unveiled in the 2009 budget in September 2008. The government has announced a number of economic stimulus measures, including Skr28bn (US\$3.6bn) in additional spending spread over 2009-11 to boost employment creation and training. It will also provide a total of Skr28bn in aid, mostly in the form of loan guarantees, to the ailing car industry. In light of the global financial turmoil, the government has widened its deposit guarantee scheme and has passed a financial stabilisation package, which includes a government loan guarantee scheme for debt, a stabilisation fund to deal with liquidity problems and equity injections if necessary." (There's one reference to the government having recently cut UI, though it isn't clear what EIU means by recent here. In any event, the overall stance of fiscal policy is expansionary.) Elsewhere they imply that the Skr28bn is the only new stimulus measure: "The government has announced further measures to stimulate job creation and stave off the effects of the economic downturn. The package will involve Skr28bn (US\$3.6bn) in additional spending spread over 2009-11."
3. Say they expect debt/GDP to start rising. No numbers.
4. Global financial crisis. Effects on Sweden are moderate.

**2009M7:**

1. Expansionary. The only thing that's clearly a change is Skr10bn (0.3% of one year's GDP), spread over 3 years.
2. (b). Language is very similar to previous report. But both a comparison of the numbers EIU gives with those in the previous report and a few specifics strongly suggest that there have been additional stimulus actions. (Not clear that there has been anything new in financial or auto rescue.)
3. Say they expect debt/GDP to start rising, and give a number (greater than 50% by end-2010; the current number appears to be in the low 40s). Here and earlier, no indication that this is viewed as a problem.

4. Severe recession. Swedish banks have big exposures to the Baltics. Government is lending to the Riksbank so it can build up its foreign currency reserves (not really fiscal policy).

#### **2010M1:**

1. Expansionary.
2. (b). “The government is pursuing an expansive fiscal policy that focuses on responding to the economic downturn as well as continuing its programme of tax and welfare reforms. ... The 2010 budget contains new measures that will cost Skr32bn (US\$4.6bn) in 2010 (equivalent to around 1% of GDP).”
3. Discuss debt/GDP ratio and recent government projections for it (with much lower numbers than in previous report). EIU views public finances as healthy, at least relative to most other EU countries.
4. Economy appears to be starting to grow.

#### **2010M7:**

1. Expansionary. The only item that’s clearly new is slightly more than 0.1% of GDP.
2. (b). “The government is pursuing a moderately expansive fiscal policy that focuses on supporting recovery from the severe economic downturn in 2009, as well as continuing its programme of tax and welfare reforms that are designed to increase the incentive to work. ... The 2010 budget contained measures that will cost Skr32bn (US\$4.4bn) a year (equivalent to around 1% of GDP), to which an extra Skr4.9bn (US\$680m) was added with the interim budget on April 15th.”
3. Slight discussion of debt/GDP, EIU views it as perhaps a small issue: “a moderate deterioration in the public finances in 2009, but they remain in much better shape than those of most other EU countries. ... Any government will, on the one hand, be constrained by what it has promised in the election campaign, but on the other hand, it will want to avoid increasing the deficit, which would bring further problems later in the term. The public debt/GDP ratio will be kept at just 40% of GDP.”
4. Economy is recovering.

#### **2011M1:**

1. Expansionary. The new item is 0.4% of GDP. Note that the EIU isn’t very clear about the size of the overall stimulus. The swing in the headline budget deficit from high to low is about 9% of GDP. In the measures adopted in 2009, the direct spending seems to be about 1% of a year’s GDP, spread over 3 years, and there are tax cuts, about which the EIU does not report the size but seems to imply that they are larger than the direct spending. Additional measures adopted over the next year and a half are about 1.8% of GDP. And there’s about 1% of GDP on bailing out the auto industry, but that’s mainly loan guarantees. So, roughly 4 to 5% of GDP? And there’s another 1% of GDP or so in 2012M1.
2. (b). “The 2011 budget will be slightly expansive (introducing a package of spending increases and tax cuts amounting to just under Skr13bn), following a moderately expansive fiscal policy in 2009-10 to support recovery from the severe economic downturn.”
3. Mention debt/GDP a few times in a positive way. “With public debt at around 40% of GDP (well under the EU average) ..., there is no need for major fiscal tightening,” and, “low public debt.” Projections are for declining debt/GDP.
4. Rumblings of fiscal consolidation to come. For example, “The government will focus on strengthening the public finances .... On the assumption that expenditure is brought under tighter control.” And, “with the government aiming to return the budget to surplus

by 2012, public spending growth is likely to be slower over the forecast period than in recent years.” Also, the government has extended some loan guarantees for banks, but this does not seem to have any noticeable fiscal implications.

#### **2011M7:**

1. Neutral or slightly contractionary.
2. (h) and/or (f). To the extent anything is happening on the fiscal front, it's that the government is letting previously enacted stimulus wind down (“the phasing-out of fiscal stimulus”), which seems like normal countercyclical policy and which we don't put any real weight on (though it might have an ideological component (f) in this case), and proceeding (in a fairly modest way) with its long-run program of restraining spending growth, supply-side reforms, and selling state-owned assets (f). (There is also a tax-cut component to the long-run program, but nothing seems to be happening on that front.)
3. Discussion of debt/GDP and long-run fiscal health is essentially identical to the previous report's.
4.
  - This report is very similar to the previous one.
  - Some of what appears to be going on in 2010 and 2011 is that policymakers are taking additional actions that are at the margin expansionary but not enough to fully offset the end of the initial stimulus. This is happening as the economy is recovering well from the crisis, so to the extent one might want to describe it as a tightening, it feels like conventional countercyclical policy, not austerity. (As described below, in 2012 the economy weakens, and they respond with more (countercyclical) stimulus.)

#### **2012M1:**

1. Expansionary.
2. (b). The economy grew strongly in 2011, but real GDP is expected to be roughly flat in 2012. “With public debt and the government deficit low, the coalition has been able to introduce some stimulus measures.” “The 2012 budget includes infrastructure investment in rail and road, a labour market package to address the effects of the downturn, .... The budget is expected to inject a total of Skr15bn into the economy in 2012 and Skr17.3bn in 2013 [each of which is about ½% of GDP].”
3. There's also a procyclical piece of policy: a tax cut proposal was withdrawn “on the grounds that a deteriorating economic outlook could adversely affect revenue.” The government's long-run program is the same as before, but not a lot is happening on that front. EIU's discussion of debt/GDP is again upbeat, though now they expect debt/GDP to hold roughly steady rather than decline.

#### **2012M7:**

1. Expansionary. The measures seem pretty small. For example, the housing measures are less than 0.1% of GDP.
2. (b). “The government's policy programme is likely to focus on supporting employment, closing tax loopholes and raising housing market flexibility in the near term. Fiscal policy is likely to be slightly expansionary in 2013.” “In the face of an economic slowdown in 2012, economic policy is prioritising employment creation, in particular for young people and through new temporary jobs. ... The government has announced measures that are designed to make housing more affordable, such as by cutting property tax ... and stimulating additional housing construction.” And (somewhat contradicting previous report), “As fiscal policy has not been expansive in 2012 so far .... In 2013 the government may however adopt a slightly more expansionary budget ... in order to counteract some of the effects on the economy of the prolonged euro zone crisis.”

3. Usual upbeat discussion of debt/GDP and long-run fiscal health.
4. Also, no big action with the government's long-run program.

**Bottom Line: Despite its comparatively small-government, supply-side ideology, the Swedish government pursued moderately expansionary fiscal policy throughout, for both financial rescue and, especially, countercyclical reasons. The EIU thought that Sweden's initial surplus and low debt were important reasons such expansion was feasible. The degree of stimulus was adjusted (in both directions) in response to the state of the economy.**

## **DENMARK (2009:1)**

### **2009M1 (pre-crisis):**

1. Expansionary.
2. (a) and (b). "The ... government's main short-term policy priorities will be to ensure the stability of Denmark's financial institutions and to alleviate the effects of a sharp economic downturn." The stimulus isn't large, but more may be coming: "The budget foresees a fiscal stimulus of roughly 0.4 percentage point of GDP, via a long-planned reduction in income taxes and higher spending for public infrastructure. Pressure is already building for additional measures to combat the economic downturn."
3. A couple of references to policymakers' (and the EIU's) concern about "the medium-term sustainability of the public finances" despite the fact that "Denmark has maintained a healthy budget position in recent years, with an estimated surplus of 3.3% of GDP in 2008." No mention of size of the debt.
4. Recession and significant credit disruption. (We have 2008H2 as a 6.) Lots of talk of further stimulus and financial rescue.

### **2009M7:**

1. Expansionary.
2. (a) and (b). "The government's main short-term policy priorities will be to ensure the stability of Denmark's financial institutions and to alleviate the effects of the sharp economic downturn, through tax cuts and higher public spending." Since the previous report, Denmark has done more in terms of both financial rescue (including recapitalization worth "up to" about 4% of GDP) and stimulus (the only thing the EIU gives numbers for is accelerating about 1.3% of GDP of infrastructure spending, but there are other measures as well).
3. Even more references to concern about long-run fiscal outlook. Emerging budget deficit is limiting government's "room for manoeuvre" even in the short run. EIU says that the level of debt is "low in comparison with many other European countries" (central government is about 10% of GDP, general government about 40%), and that Denmark's sovereign debt is triple-A rated. Nonetheless, EIU thinks the fact that debt/GDP is now rising "will force the Danish government to reassess its future tax and spending plans."
4. Continued recession and significant credit disruption.

### **2010M1:**

1. Expansionary (including recent agreement on the 2010 budget). EIU again does not tell us the size, though overall swing in the deficit is about 9% of GDP.
2. (a) and (b). Same statement as before about priorities.
3. Again, discussion of level of debt, good sovereign ratings, and concern about "the medium-term sustainability of the public finances." Less material than in previous report about how this will affect policy. But this time, the EIU reports that Denmark is now in violation of the Stability and Growth Pact, but says that the expected recommendation for correction will be "mild" and similar to what Germany will get.
4.
  - Real GDP is starting to grow.
  - EIU expects stimulus to start to be withdrawn.

### **2010M7:**

1. Contractionary (in the sense that recent actions and focus of current discussions are all in that direction). "[T]he government's austerity package for 2011-13." "Economic policy is now focusing on how to reduce the budget deficit to below 3% of GDP by 2013."

2. Probably (f). The EIU largely just takes it as given that there has to be fiscal consolidation. For example, “The need for budgetary consolidation.” One explicit indication that it’s domestically-driven: “the deterioration in the public finances has also made the electorate aware of the long-term costs of sustaining Denmark’s welfare benefits.” There is no explicit mention of EU rules (though there is the one statement above that the focus of fiscal policy is getting the deficit below 3% of GDP).
3. Deficit clearly viewed as a problem, in the sense that there is a consensus that it needs to come down. Similar discussion of level of debt as before (rising, but low by European standards).

#### **2011M1:**

1. Contractionary. “[P]olicy will become more restrictive from 2011 in order to reduce the budget deficit below 3% of GDP by 2013.” “Economic policy will be focused on containing the rise in the budget deficit in 2011 and reducing it thereafter.” Not large: “the 2011 budget projects a negative fiscal effect equivalent to 0.3% of GDP in 2011 and 0.5% in 2012.”
2. (f), and a little (g) (EU rules). EIU isn’t all that clear. As before, largely takes it as given that the deficit needs to come down (for example, the need to ensure “the sustainability of the public finances”). But stronger hints that domestic ideas are important: The prime minister “used his final New Year address before the next general election to highlight the need for deeper structural reform of the welfare system to prepare Denmark for the future fiscal challenges of population ageing”; and, “A consensus appears to be emerging that, if spiralling public budget deficits are to be avoided.” And a mention of EU rules and agreement with the European Commission: “The deficit is still expected to fall below 3% of GDP by 2013, as agreed with the European Commission.”
3. Similar discussion of level of debt as before (rising, but “moderate by regional standards”).

#### **2011M7:**

1. Contractionary. Deficit/GDP is up a little, but that seems to be from slow growth and technical factors; policy action and discussions are all contractionary. “Economic policy will focus on containing the rise in the budget deficit during 2011 and reducing it thereafter.”
2. (f), and a little (g) (EU rules). Again, EIU isn’t all that clear. But one indication of a strong domestic consensus that austerity is necessary: “The opposition’s programme is similar in certain respects to the government plan, taking as a starting-point the assumption that the impact of population ageing and dwindling North Sea oil reserves will require a budget adjustment of Dkr47bn (US\$8.4bn) by 2020 to ensure a balanced budget.” And basically the same statement about European rules as before: “the budget deficit will fall back below 3% of GDP in 2013, as agreed with the European Commission.”
3. Similar discussion of level of debt as before (rising, but “moderate by regional standards”).

#### **2012M1:**

1. Expansionary. Described as “modest.”
2. (b): The report says, “Domestic demand will receive some support during 2012 from fiscal stimulus,” and refers to “a faltering economy,” though the EIU does not explicitly link them. (Some of the reason for the exact timing is that there’s a new government that’s more favorably disposed to stimulus: “The focus of economic policy will shift under the centre-left government .... The new coalition is introducing an additional,

modest stimulus to the economy in 2012.” Nonetheless, the underlying motivation is a desire to provide stimulus in the face of a weak economy. Also, it’s not a big ideological shift—see below.)

3.
  - Deficit still clearly viewed as a long-term problem (new government “retains the previous government’s medium-term budget targets” and concern with “medium-term fiscal consolidation”).
  - A passing mention of EU rules (“Denmark is likely to miss the target agreed with the European Commission, of 3% of GDP in 2013.”) The fact that missing the target is viewed as no big deal is perhaps evidence that it was not ever a major motivation.
  - Similar discussion of level of debt as before (rising, but “moderate by west European standards”).

#### **2012M7:**

1. Slightly contractionary? EIU describes fiscal policy as expansionary, but with the exception of “a new initiative providing more apprenticeships to lower youth unemployment,” there’s nothing new in this report. And there’s a plan for long-run fiscal improvement. It seems to be mainly about increasing incentives to work, not raising taxes or cutting government spending. But there are references to caps on public spending and vague references to higher future taxes.
2. Perhaps a tiny bit of (h) (economy is doing less badly), a tiny bit of (f) (deficit viewed as a problem), and a tiny bit of (d) (government wants to “ensur[e] that Denmark retains its AAA credit rating (even though the country does not appear to be at risk of being downgraded”).
3. Usual concern about the long-term deficit. Usual discussion of level of debt. No mention of EU rules.

#### **2013M1:**

1. Slightly contractionary? Very similar to previous report. Only policy change described is, “The centre-left coalition also agreed on a tax reform and discussions with the social partners on labour market reforms to raise labour supply.” But EIU says nothing about specifics, or even direction.
2. Perhaps a little bit of (f) (deficit viewed as a problem). “The coalition ... retains the previous government’s medium-term budget targets. It has also introduced ceilings on public spending at the national, regional and municipal levels”; and EIU implies that a goal of “the government’s long-term reform agenda” is to achieve budget surplus (though it does not expect it to succeed). No mention of EU rules. No mention of credit ratings.
3. A little bit of concern about the long-term deficit. Usual discussion of level of debt, except that debt/GDP is now viewed as stable rather than increasing.
4. Economy has weakened.

**Bottom Line: Denmark initially pursued slightly expansionary fiscal policy for countercyclical reasons and financial rescue. But policy then turned generally moderately contractionary. The switch stemmed mainly from policymakers’ ideas about the benefits of fiscal responsibility, with a secondary role for EU rules. There was only one minor mention of concern about market access.**

## **GREECE (2009:1)**

### **2009M1 (pre-crisis):**

1. No clear pattern. There has been some austerity, but also some expansionary measures. Nothing appears large.
2.
  - Expansion: (a) and (c). “In response to the recent financial crisis, the government will also provide social benefits to support lower-income groups and offer a package to shore up liquidity in the banking sector” (the latter is loan guarantees of 11% of GDP). And the EIU interprets a recent cabinet reshuffle as showing “that the ruling New Democracy (ND) has abandoned its efforts to maintain fiscal discipline in a bid to boost its popularity.”
  - Contraction: Even at this early stage, there has been a rating downgrade, “risk aversion on the part of investors,” and a sharp rise in spreads (d). There are also some discussions of violations of the SGP’s 3% limit, but no indication of consequences beyond, “According to press reports, the Commission will send a team to Athens in January 2009 to examine 2008 budget data” (g).
3. The EIU comments on the high level of debt and views it as a reason for investor worries.

### **2009M7:**

1. In terms of conventional policy, there are both expansionary and contractionary policies. The EIU isn’t clear about the overall direction, but the effect is small. There are also some financial rescue measures. So on net it appears to be a small expansion.
2.
  - On the expansionary side:
    - (b): “In response to the impact on Greece of the severe downturn in the global economy, the government is introducing a number of mitigating measures.” However, they seem small, and in the same paragraph, the EIU says, “However, Greece’s dire fiscal position means that the government is at the same time being forced to cut other elements of its expenditure.”
    - (a): “The government has also announced a €28bn scheme to shore up the banking industry: €5bn in capital injections [about 2% of GDP], €15bn of state loan guarantees and €8bn of liquidity in the form of special bonds.” €28bn is the same number as the previous report gave for the loan guarantees; not clear if the announcement described here is an additional measure or a rearrangement of the earlier one. “Greek banks are considered structurally sound .... However, the banking sector may require further support.”
  - On the contractionary side, the measures are about 1% of GDP (roughly €2 billion of recently announced tax measures, plus “€1.2bn in ... cost-cutting measures ... introduced in March.” (g) (EU rules) are clearly important, with some role for (d) and conceivably a little (f).
    - (g): “the economy and finance ministry revealed that, without further measures, this year’s budget deficit will exceed the target of 3.7% of GDP (as stipulated by the European Commission) by approximately €2.3bn. To bridge this gap, the government intends to raise €1.9bn in new taxes and levies and €400m from a stepped up campaign against tax evasion. ... Greece was placed under surveillance under the EU’s excessive-deficit procedure (EDP) on April 27th. The European Commission established a deadline of 2010 for Greece to bring its deficit back under the 3% of GDP threshold and recommended that it target a balanced budget by 2013.”

- (d): “Greece’s high deficit and debt load caused the spread between ten-year Greek bonds and ten-year German bunds to soar in 2008 and the start of 2009. Although this spread has narrowed, it may widen further in 2009-10.”
  - (f): There are some broader references to fiscal problems (the governing party “positions itself as the party capable of implementing tough but necessary austerity measures,” and “Greece’s dire fiscal position”). It isn’t clear whether these are affecting policy via ideas (f), as opposed to just working through (g) and (d).
3. Deficit clearly viewed as a problem by policymakers and the EU. Some discussion of the high and rising debt/GDP ratio.
  4. Global recession; Greece is doing badly but not terribly.

### **2010M1:**

1. Contractionary.
2. (d), a fair amount of (g), and perhaps some (f). Repeated references to “fiscal crisis,” “The main focus ... will continue to be reining in the ballooning budget deficit and public debt,” etc.
  - (d): “In December the three main international ratings agencies downgraded Greek sovereign debt,” “Although not our central scenario, there is a risk that Greece could require a bail-out to avoid default if investors are unwilling to purchase Greek debt,” soaring spreads, etc.
  - (g): “Of the 11 euro zone member states subject to an excessive-deficit procedure (EDP), Greece was the only country not be granted a grace period for bringing its deficit below 3% of GDP. Instead, the Commission deemed that Greece had not undertaken sufficient austerity measures and placed it under the first of four levels of sanctions, requiring Greece to publish detailed accounts of its deficit and debt positions before issuing sovereign debt”; reference to pressure to “calm international agencies”; and more.
  - (f): The prime minister has accelerated the timetable to get the deficit down to 3% of GDP, so they seem to be doing more than the EU is insisting on (this isn’t 100% clear, however, and it could be a response to market access issues).
3. The deficit is clearly viewed as a huge problem by policymakers and the EU. There is discussion of the high and rising debt/GDP ratio.
4. New government. Vast upward revision of 2009 deficit number. The government successfully sold some long-term debt.

### **2010M7:**

1. Contractionary!
2. (e) (in turn due to (d): “the prime minister, George Papandreou, requested a joint lending facility from the IMF and euro zone partners. On May 2nd 2010 the IMF, euro area members and the Greek government announced that they had agreed a package for Greece amounting to €110bn [almost 40% of GDP], in exchange for which Greece would implement a draconian fiscal austerity package.” Although the EIU isn’t explicit, presumably one reason for seeking help is that “the cost of borrowing in the markets remains prohibitively high for Greece.” A chart on p. 7 shows that spreads had gotten extremely high. Also, “fears that investors would demand a punitive risk premium on Greek debt” (in the context of trying to sell 1-year debt, though the government did sell 6-month debt); and both S&P and Moody’s have downgraded Greek debt to junk status (with the Moody’s downgrade being four notches); this has made “[t]he prospect for returning to the market for borrowing became even less palatable.” “The government’s primary focus in 2010-11 and beyond will be to rein in the budget deficit and public debt

and boost competitiveness by implementing austerity measures and legislative reform agreed with the IMF and euro zone members.”

3. See above. Also, “The government expects the debt to stabilise at around 150% of GDP in 2013.”
4. Concerns about the banking system.

#### **2011M1:**

1. Contractionary!
2. (e) (in turn due to (d)). Overall policy: “the government implements the austerity package that it agreed with the IMF and the euro zone in order to gain access to a €110bn lending facility.” The motive for seeking the IMF/European package is described as, “Facing unsustainable interest rates on the bond markets.” Also, “the price [interest rate] of long-term debt remains unsustainably high” (though Greece again successfully sold 6-month debt). “[P]rices for longer-term debt in the secondary markets have soared, with ten-year government bonds ... [having a] spread with the comparable German bunds hovering around 950 basis points. Rates on five-year credit default swaps regularly stand at between 1,000 and 1,050 basis points, which implies a 40% risk of total default within five years and a 65% to 84% risk of a haircut of between 30% and 50%.” Similar statement as previous report about reining in deficit and debt.
3. See above. “Public debt is forecast to rise to about 156% of GDP by end-2011.” The EIU expects a haircut that will lower this substantially.
4. Banks may need a bailout.

#### **2011M7:**

1. Contractionary!
2. (e). “Economic policy will be largely dictated by Greece’s need to obtain financial help from EU partners and the IMF, requiring tax rises, continuing expenditure cuts and a range of structural reforms.” “Whatever government is in power is unlikely to have much choice about the policies that it pursues.” “At the end of June 2011, parliament approved a new draconian €28bn MTFS [medium-term fiscal strategy] of public-spending cuts and tax rises .... This was a precondition for receiving the next instalment of emergency funds from the May 2010 €110bn EU/IMF lending facility.”
3. See above. “Greek sovereign debt is expected to reach 156% of GDP at end-2011.” The EIU continues to expect this to be reduced by a large haircut.
4. There is work on a second agreement with the Troika for roughly an additional €120 billion.

#### **2012M1:**

1. Contractionary.
2. (e): “it is hard to see that the country has any other option but to follow the dictates of the so-called ‘troika’ .... [T]he main conditions imposed by the troika have been severe expenditure cuts and tax rises.” There is more resistance to austerity, and what Greece has actually done has fallen short of what it said it would do. But the overall thrust of policy is clearly contractionary. There is little about interest rate spreads or market access (probably because it’s so far from being relevant).
3. Usual.
4. “[I]nterim unity government.” A debt write-down of roughly 50% in present value terms is being negotiated.

#### **2012M7:**

1. Contractionary.

2. (e). There is even more resistance to austerity, and much of the focus of new measures is on things like privatization. Nonetheless, the overall direction of policy is continued austerity in exchange for troika support. “[T]he country’s squabbling politicians backed ... a continuation of the tough austerity measures demanded in return for bail-out cash”; “If Greece stays in the euro area, economic policy will remain guided by the two Memorandums of Understanding (MoU) that Greece agreed with its international creditors, focusing on deep austerity and structural reforms”; “In its policy programme adopted in early July 2012, the ND-Pasok-DIMAR coalition agreed to prioritise bringing the implementation of the MoU back on track in order to secure continued release of bail-out funding.” The government is selling 3- and 6-month debt successfully (at roughly 4% interest, which is presumably a big spread over Germany). No mention of spreads on longer-term debt (presumably because they are so far from relevant).
3. Usual. A fair amount of discussion of likely path of debt/GDP, with or without further haircuts.
4. New government. There has been a debt write-down. EIU expects another.

### **2013M1:**

1. Contractionary.
2. (e). Similar to previous. There is a lot of resistance to austerity and incomplete follow-through on some of what has been enacted, but the overall direction is still clearly contractionary. For example, “ongoing fiscal austerity”; “in November 2012 the government secured parliamentary approval for two important austerity and reform packages.” No discussion of market access for long-term borrowing (again, it’s presumably out of the question). But Greece has been doing some (expensive) short-term borrowing in the market because of delays in doing things that would get the troika to provide more funding: “Greece’s liquidity crisis (which the country had to bridge by issuing expensive short-term Treasury bills ...).” “[E]uro zone finance ministers and the IMF struck a deal that aims to reduce Greece’s public debt to below 110% of GDP by 2022.”
3. Various discussions of Greece’s “huge debt,” often with numbers.
4. Still no Syriza (they don’t come to power until 2015). There have been various adjustments to the timing of when Greece needs to repay its debt, the interest rate, etc. EIU expects another write-down.

**Bottom Line: Greece’s initial fiscal policy response consisted of a small expansion for financial rescue and small conventional fiscal actions in both directions driven by a range of motivations, with at most a small net fiscal expansion. But policy soon turned to austerity, which became increasingly severe over time. The initial turn to austerity stemmed from a combination of EU rules and issues with market access, with hints of a role for domestic policymakers’ ideas. The later, harsher austerity came about as Greece lost market access and then turned to international organizations for aid, which came with strong conditionality.**

## **HUNGARY (2009:1)**

### **2009M1 (pre-crisis):**

1. On net contractionary, though there is a bank rescue package.
2.
  - (e). An IMF-led bailout October 2008 requires austerity. (The EIU describes the package as a result of financial turmoil: “In the aftermath of the turmoil that hit Hungarian financial markets in October 2008”; “The forint depreciated markedly in October 2008, illustrating the currency’s vulnerability in the context of continuing turbulence on international financial markets. The forint plunged to a historic low of around Ft286:€1.” EIU says the package “should be sufficient to stabilise the Hungarian banking sector and the public finances over the forecast period,” suggesting problems in both areas.) In addition, they had already agreed to a declining path of the deficit in order to join the euro. One reference to a desire “to regain the confidence of financial markets.”
  - (a). The bank rescue package is roughly 2% of GDP, and allows for capital injections. “So far, however, no bank has indicated that it will draw on the facility.”
3. Discuss the level of debt/GDP and its expected path.
4. Financial crisis and severe recession. Government is providing some support for banks. Also, it isn’t clear how domestic policymakers view budget policy. They would clearly like it to be much looser than the IMF, etc. are letting them. Whether they would like it to be expansionary (rather than less contractionary) isn’t clear.

### **2009M7:**

1. Very contractionary: “tough fiscal measures”; “The new prime minister, Gordon Bajnai, has promised to make further deep cuts in fiscal spending”; etc. Sum of recent and previously enacted spending cuts is 5% of GDP. There is also some financial rescue (a): “The government has adopted a bank bail-out package.”
2.
  - Financial rescue (a): The purpose is described as being to “minimise” a “risk” to the banking sector, suggesting that no major interventions have taken place. The previous report includes similar language about risks.
  - On the contractionary side, largely (e). Fiscal policy is being very much driven by the IMF-led bailout (the EU is also involved). Also, hints of some (f), (d), and (g): the new prime minister is more ideologically in tune with the IMF views than the previous one; a couple references to concern about investor confidence; and Hungary would like to join the euro.
  - Some relevant statements: “The Fund has enforced strict conditions, such as continuing fiscal consolidation.” “The new cabinet will aim to keep the public finances in check so as to guarantee a steady flow of funding from the multilateral agencies and to ensure that investors do not lose confidence.” Recent political developments mean that “there is an increased commitment to fiscal tightening.” “The SZDSZ [a party supporting the new government] has been calling for even more radical steps than those that the IMF and other multilateral lenders attached as conditions to the financial assistance package that was agreed with Hungary in October 2008.” “The target [for the deficit] is likely to be met, as any signs of slippage would spark a loss of investor confidence in Hungary.” “The government sent an updated convergence programme for euro membership to the EU in May.”
3. EIU clearly views the deficit as bad (that is, views the austerity as good/necessary).
4. Financial crisis and severe recession.

**2010M1:**

1. Contractionary. (But other than the adoption of some fiscal rules, it isn't clear that there have been any new actions since the previous report. On the expansionary side, there's a bailout of an airline and a vague reference to some populist proposals in view of the upcoming election; but austerity clearly dominates.)
2. Largely (e), with a little (d) and perhaps a tiny bit of (g) and (f). Fiscal policy is still being very much driven by the IMF-led bailout. Desire to join the euro is also encouraging austerity. A couple references to concern about investor confidence, and one indication that the prime minister is ideologically in tune with IMF views. "The government will aim to keep the public finances in check so as to guarantee a steady flow of funding from the multilateral agencies and to ensure that investors do not lose confidence." A reference to the need for "enough fiscal prudence to retain the confidence of investors and international creditors. Tight financial management is also a prerequisite for the earliest possible introduction of the euro." The prime minister's views imply "a consistent commitment to fiscal tightening by the current government."
3.
  - One reference to the central bank expressing concern about high debt/GDP (though the EIU does not give any numbers), in the context of market access (d): "the NBH [National Bank of Hungary] also pointed to the high volatility in recent months in international investor sentiment and assessments of risk associated with Hungarian financial assets. Investor concerns about the sustainability of government debt in a number of countries have come to the fore. The NBH stressed that it was important to maintain a disciplined and sustainable fiscal policy, in order to reduce Hungary's high levels of public debt and vulnerability to external shocks."
  - EIU clearly views the deficit as bad, and the austerity as good/necessary.
4. Very similar to previous report.

**2010M7:**

1. Contractionary. (A little complicated. New government is doing both expansionary and contractionary things. But the bottom line is, "The Economist Intelligence Unit's baseline forecast is for steady fiscal consolidation over the forecast period, with fiscal targets agreed upon in consultation with multilateral lenders.")
2. Largely (e), with a noticeable amount of (d). Fiscal policy is still being driven by the IMF-led bailout. There are also a bunch of references to concerns about market confidence. (To the extent there are expansionary actions, they are from a mix of (c) [fulfilling electoral promises] and (b) [unemployment is still high].) "The new Fidesz-led government is expected to exercise enough fiscal prudence to retain the confidence of investors and creditors." "Fidesz has affirmed its commitment to meeting the fiscal targets outlined by the previous government in consultation with the IMF and the EU." "[T]he IMF and the EU ... have said that they will not approve any changes to the macroeconomic policy path determined by the previous government ...—a decision that Fidesz is likely to abide by." "[T]he imperatives of ... ensuring market confidence."
3. One reference to the "sizeable state debt." EIU clearly views the deficit as bad, and the austerity as good/necessary.
4. Orban is now prime minister. Also, one thing that comes up starting with this report and continuing through the remainder (for example, it's especially explicit in the 2013M1 report) is that the fiscal consolidation from here forward is often nonstandard—lots of taxes on companies in particular sectors, near-expropriation of private pensions, and so on.

**2011M1:**

1. Contractionary. (Again complicated. But most of the recent actions described are contractionary, and EIU's bottom line is, "Our baseline forecast is for steady fiscal consolidation over the forecast period.")
2. (d) and a little (g). Hungary has told the IMF to go away, so that is no longer guiding policy. But there are innumerable references to the need to maintain investor confidence. For example, "Fidesz will have to balance meeting voter expectations against the pursuit of fiscal policies that are sufficiently strict to ensure that it does not alienate international lenders and investors." "Pressures from financial markets will force the Fidesz government to take further reform steps to consolidate the public finances and so reduce the state debt." "[T]he imperatives of ensuring market confidence." "Concerns about fiscal policy lead to credit downgrades" (Hungary's debt was recently downgraded two notches, to one level above junk). Also, one reference to "remaining within frameworks agreed with the EU." If not constrained, government would pursue expansionary policy.
3. EIU says, "Hungary's macroeconomic environment remains marred by high levels of debt," with no numbers. Clearly views the deficit as bad, and the austerity as good/necessary.

**2011M7:**

1. Somewhat contractionary. (Again complicated. Most of what the government has announced since the last report is contractionary, but not much has happened, and "the government's commitment to fiscal consolidation remains unclear.")
2. (d). Multiple references to the need to maintain investor confidence (though not quite as prominent as in the previous report, perhaps because "[t]he current financing position means that Hungary can manage without official funding for the time being"). For example, "Hungary has run steady budget deficits over the past decade, and public debt topped 80% of GDP, the highest level among new EU members, at end-2010. To retain investor confidence and ensure medium-term debt sustainability, fiscal consolidation is needed," and, "The party will have to balance its populist inclinations against the need to retain investor confidence." "The Commission and the IMF both called for an exact timetable on Hungary's path towards a state debt ceiling of 50% of GDP." And again, if not constrained, government would pursue expansionary policy.
3. Mention debt/GDP and refer to concerns about sustainability. EIU clearly views the deficit as bad, and the austerity as good/necessary.

**2012M1:**

1. Somewhat contractionary. (Again complicated. But again, most announced actions are contractionary. The EIU says, "our central scenario assumes only partial implementation," but they also say more than once that they expect consolidation to be a drag on demand.)
2. Mainly (d), some (e), perhaps a tiny bit of (g). A bunch of references to market confidence, a few to high risk premiums, a few to credit rating agencies (including the fact that Moody's has downgraded Hungary's bond rating to junk). Also, Hungary has flip-flopped and is now back talking to the IMF (though the EIU isn't sure it's serious); and the IMF help "would come with strict fiscal conditionality." Some relevant statements: "Fidesz will have to balance its populist inclinations against the need to retain investor confidence"; "Hungary's high risk premium"; "surging credit default swap rates, rising bond yields and a downgrade into junk category by Moody's"; "Hungary seeks new IMF deal under downgrade pressure." One reference to 3% deficit target.

3. Level of debt and debt/GDP mentioned several times, once with numbers. As always, EIU clearly views the deficit as bad, and the austerity as good/necessary.

**2012M7:**

1. Somewhat contractionary. Little has happened since previous report, but the government is continuing on the consolidation path. To the extent there were any new actions, they seem consistent with this.
2. (d), (e), and (g). Multiple references to confidence, risk premiums, and so on. Hungary is still talking to the IMF (and the EU), and these are more prominent in the EIU's analysis. "Fidesz's populist tendencies have been partly curbed by the need to secure an international bail-out." "To retain investor confidence." "Throughout the six-month stand-off with the IMF and the EU, Hungary's borrowing costs have climbed steadily, with ten-year bond yields rising to an unsustainable 11% and CDS spreads rising to above 7 percentage points." Also, multiple references to the 3% target. Finally, the EIU says (perhaps for the first time in these reports) that there has been an ongoing EU excessive deficit procedure against Hungary since 2004.
3. Level of debt and debt/GDP mentioned several times, once with numbers. As always, EIU clearly views the deficit as bad, and the austerity as good/necessary.

**2013M1:**

1. Contractionary. Not a lot new, though again the new actions are largely contractionary. EIU again expects fiscal consolidation to be on net a drag on the economy.
2. (d), (e), and (g). Quite similar to previous. Talks with IMF and EU still ongoing.
3. Level of debt and debt/GDP mentioned several times, once with numbers. As always, EIU clearly views the deficit as bad, and the austerity as good/necessary. Different ratings agencies has moved their outlooks or ratings in different directions.
4. EIU mentions that Hungary has not issued bonds in international markets since May 2011.

**Bottom Line: Despite a small initial bank rescue, fiscal policy in Hungary was on net contractionary throughout, often strongly so. It was initially driven mainly by conditionality associated with an IMF-led program that predated the crisis. Later, it was driven mainly by concerns about market access, with some role for attempting to obtain renewed IMF support. A desire to comply with EU rules in order to join the euro played a role at times, but was never central.**

## **IRELAND (2009:1)**

### **2009M1 (pre-crisis):**

1. "The government announced a recapitalisation plan for the three main Irish banks on December 21st. The deal will see the government initially inject €5.5bn in the form of preference shares into three banks." "The injection will be funded by the exchequer (€1.5bn) and the national pension fund (€4bn)."
2. (a): See (1) above. "Managing the banking and public finances crises will mean that there will be less scope for new initiatives, particularly any which require financial resources." This suggests that the big financial rescue is perhaps limiting other types of fiscal expansion.
3. "Second, the chances of a government injection of capital into the banking system are rising. This would involve large upfront costs, adding significantly to the stock of public debt. Third, yield spreads on Irish government bonds reached 168 basis points by January 9<sup>th</sup> 2009, from 20 basis points at the beginning of 2008. The current yield spread continues to widen and is second only to that of Greece in the euro area. The rising risk premium on Irish government debt is already raising debt-servicing costs. Given massive new bond issuance by most industrialised countries in 2009, the Irish government could conceivably face funding difficulties in 2010."
4. "The Irish banking system remains in a precarious state despite liability guarantees and public recapitalisation. The full nationalisation of most or all of the banks is a small but conceivable possibility over the outlook period."

### **2009M7:**

1. Financial rescue is very expensive. Guaranteed the main commercial banks' liabilities, nationalized one bank, recapitalized others, and agreed to buy NPLs. There seems to be substantial conventional austerity (obviously counteracted by massive spending on financial rescue). "The budget deficit is estimated to exceed 12% in 2009-10. The risk of default is small but real." "Budget deficits averaging 12.8% of GDP are expected in 2009 and 2010 despite large tax rises and some significant reductions in public expenditure."
2.
  - The main source of fiscal developments is the financial rescue (a). "Despite a series of radical measures that the government has introduced, the banking system remains more fragile than in any other euro area country." "[T]he government is taking all possible measures to support the financial system."
  - The austerity that is being taken on other fronts appears to be due to concern about market access (d). The EIU doesn't say this explicitly, but there is much discussion of the government trying to deal with the fiscal crisis.
  - "Attempting to manage this wide-ranging economic crisis will dominate government energies in 2009-10 and beyond. To compound these difficulties, the two-party coalition government is faced with a self-inflicted crisis in the public finances. The running of double-digit budget deficits at a time of such chronic international uncertainty has raised questions about the willingness of the bond market to finance such funding needs. There is now a small, but not inconsiderable possibility that Ireland will be unable to finance its deficit spending before the end of the outlook period."
3.
  - "The Irish public finances are in a state of profound crisis."
  - "The fact that yields on Irish government bonds have remained far above their German equivalents and are the highest in the euro zone illustrates the degree of concern in international markets about Ireland's budgetary position." "The

publication of half-year public finances figures has added to concerns about the sustainability of Ireland[’s] budgetary position.” “These [budget] figures, further bank bail-out costs and the downgrading of Irish government debt by Moody’s ... have all contributed to the increased risk perception of investors and Ireland is now considered by far the riskiest of the euro area member countries to lend to.” (Irish debt has a higher spread than Greek debt.)

4. Banking system is still very vulnerable.

#### **2010M1:**

1. The net stance of fiscal policy is hard to identify, but austerity seems the most likely. The EIU wrote: “Government is (finally) on the right fiscal path.”
  - “The budget deficit is forecast to reach 12.4% in 2010, before declining gradually thereafter. The risk of default (or a bail-out to prevent this) is small, but real. This could have dire political consequences.”
  - “The government intends to buy non-performing loans with a book value of €77bn from these institutions.”
  - “The biggest single hurdle at the end of 2009 was to push through parliament an austerity budget for 2010.” “[F]iscal adjustment worth 2.5% of GDP. This is to be achieved almost exclusively by expenditure reductions (the government has explicitly acknowledged that international evidence points to spending cuts being a more effective route to consolidation than tax increases ...).” This could suggest an element of a role for ideas (f), but it is really about the composition of fiscal policy, not the overall direction.
  - “The recent budget measures have reduced but not eliminated the risk of funding difficulties.”
  - “Public spending is being cut as the government attempts to control an exploding budget deficit.”
2. Market access seems to be a plausible explanation (d): “the government unveiled its much-flagged austerity budget, designed to further a process of budget consolidation that is needed to stabilise the country’s precarious fiscal position. The plan contained some of the most politically painful measures introduced by any government in the Irish state’s near-century-long existence.” Spread on Irish bonds over German soared to close to 300 bp in early 2009. The spread fell to 148 bp in January 2010.
3. Debt-to-GDP not explicitly mentioned. “The size of Ireland’s budgetary and banking problems and the fragility of international investor confidence mean that the risk of funding difficulties in the future has not disappeared, despite the radical nature of the budget measures.”
4. “The Irish banking system is in a precarious state.”

#### **2010M7:**

1. The net position seems to be expansion: deficit is projected to rise even though tax revenues are projected to stabilize. “Despite harsh austerity measures, we forecast the government deficit for 2010 at 18.8% of GDP, although about one-third is caused by measures to support the banks. We forecast that the deficit will fall to 9.2% of GDP in 2011.” Buying impaired loans off banks (lots). One-third of the enormous deficit will be accounted for by the intended injection of €10.9bn to cover the losses of Anglo Irish Bank. Taking fairly extreme austerity measures, including cutting public sector wages.
2.
  - Financial rescue (a) and market access (d) remain important motivations for fiscal actions. “The government’s economic policy will remain focused on addressing the financial crisis resulting from the near-collapse of the banking system and the fiscal

- crisis.” “Having guaranteed the main commercial banks’ liabilities, nationalised one bank, recapitalised others and agreed to buy at a discounted price impaired loans of a book value of up to €81bn (about 50% of GDP), the government is taking all possible measures to support the financial system.”
- “It has acted earlier than other EU countries like the UK, Greece and Spain, to persuade the population that sacrifices are unavoidable and to tackle its structural fiscal deficit.”
3. “[T]he provision on May 10<sup>th</sup> of a €750bn euro zone/IMF facility for euro zone countries in difficulty that cannot finance their deficits other than at exorbitant rates.” Irish debt was only 24% of GDP at end-2007, rising to 59% at end-2009. EIU forecasts it will reach 85.6% by end-2011.
  4. “The fiscal crisis, although less severe than in Greece, is one of the most acute amongst other euro zone members and the banking crisis is the most acute in the euro zone.”

### **2011M1:**

1. Precondition to the agreement was a 2011 budget. Budget deficit in 2010 was 32% (big chunk was bail-out for Anglo Irish Bank and two others); to 9.4% in 2011. “As a precondition to the agreement on the €85bn rescue package, the Irish government pushed through a 2011 budget and agreed a National Recovery Plan 2011-14 designed to reduce the budget deficit below 3% of GDP by 2014.”
2.
  - Motivation is a mixture of market access (d) and IMF conditionality (e): “The government’s economic policy will remain focused on implementing the austerity and financial and structural reforms agreed in exchange for access to a €85bn EU/IMF lending facility.” Bailout occurred on Nov. 28, 2010. Conditionality aims to reduce budget deficit to below 3% by 2015. “Economic policy will be largely dictated by the terms agreed by the Irish government and the EU, IMF and ECB ... in exchange for an €85bn lending facility for Ireland.”
  - (d): “Bond yields on Irish sovereign debt soared in the second half of November 2010, and the government came under immense pressure to request access to a lending facility from the European Central Bank.”
  - “In a country that is jealously protective of its sovereignty, the government’s agreement to a lending facility from the EU and the IMF was a watershed. The arrival of the IMF, EU and European Central Bank (ECB) in Dublin to negotiate the terms of the bail-out package produced a palpable shift in the public mood, with anger rising sharply.”
3. EIU expects that Ireland will be forced to restructure its sovereign debt under the ESM. “We expect a 24% haircut to reduce public debt to 96% of GDP in 2013, falling to 83% by 2015.” Current debt projections: 112% in 2011 and 126% in 2012.
4. Irish government has to continue to guarantee senior bank debt (ECB was worried that partial default could cause problems in other countries). Further series of capital injections into banks in December 2010.

### **2011M7:**

1. Continued austerity. “The present government is implementing a number of austerity measures.” Might need more to satisfy EU/IMF.
2. Conditionality continues to be main reason for austerity (e). “Economic policy will be largely dictated by the terms agreed by the previous Irish government and the EU, the IMF and the ECB in exchange for an €85bn lending facility for Ireland. ... The conditionality of the bail-out package aims to reduce the budget deficit to below 3% of GDP by 2015.”

3. EIU forecasts debt to GDP of 130% in 2012. Still thinks they will need sovereign restructuring. They think borrowing costs will still be prohibitively high in 2013. "However, it remains the Economist Intelligence Unit's view that Ireland will be unable to return to the bond markets in 2012 as current plans envisage."
4. There is a new government, but it is also committed to the same plans passed before.

#### **2012M1:**

1. Deficit was 10.3% of GDP in 2011; expected to fall to 9% in 2013 and around 2.5% in 2016 (assuming there is public debt restructuring). "The present government is implementing a programme of austerity measures."
2. "Despite its greater acceptance of austerity measures and economic growth potential, Ireland is also particularly vulnerable to the spillover effects from deepening crisis elsewhere in the euro area." Conditionality is still key (e), intertwined with market access (d). "Economic policy will be largely dictated by the terms agreed by the previous Irish government and the so-called troika."
3. Spreads have declined a lot. EIU still thinks Ireland will either need to extend the bailout plan or restructure its sovereign debt when current bailout ends in 2013. "[T]he EU agreed to reduce the interest rate on the lending facility for Ireland by about 2 percentage points." EIU expects debt to peak at about 125% of GDP in 2013.
4. GDP shrank again in 2011Q3, after recovering.

#### **2012 M7:**

1. EIU predicts budget deficit 13% of GDP in 2011 (revised up to include bank recapitalization costs) falling to 2% in 2016. Wide-ranging program of austerity.
2. Conditionality and market access ((e) and (d)) remain sources of fiscal policy.
  - "Economic policy will focus on implementing austerity policies and financial and structural reforms agreed with the" troika.
  - "Ireland will remain especially vulnerable to harmful spillover effects from the deepening crisis in the euro zone. Domestic opposition to continued austerity measures is expected to grow."
3. EU summit decided to let ESM inject capital directly into troubled banks. Ireland is expected to benefit from this decision. Ireland successfully issued some debt. Debt expected to peak at around 120-125% of GDP at end-2013. Sharp narrowing of spreads. EIU still expects that borrowing costs will be "unsustainably high and vulnerable to investors' uncertainty about the future of the euro area. As a result, the EU/IMF will either have to expand the bail-out package for Ireland for several more years to cover the country's funding costs ..., or Ireland will have to undergo a restructuring of a portion of its sovereign debt."
4. Ireland had to vote on EU fiscal treaty; it passed. Rejection would have meant Ireland would lose access to EU financial support. This helped investor sentiment.

#### **2013M1:**

1. "We forecast that the budget deficit will narrow gradually from 13.3% of GDP in 2011 (including bank recapitalisation costs), but will still be well above the official deficit target of 3% in 2017." Draft 2013 budget aims to achieve a net deficit correction of 2% of projected GDP. "The additional fiscal tightening in the 2013 budget, which was the fifth consecutive austerity package since the start of the crisis, will exert a further drag on consumer spending this year through both tax increases and cuts in welfare payments."
2. EU/IMF conditionality (e) remains the key motivation: "Economic policy will focus on implementing austerity measures and financial and structural reforms agreed with the EU/IMF in late 2010 in exchange for an €85bn ... lending facility that expires at the end

of 2013.” “Economic policy is largely dictated by the terms of the bail-out agreement of November 2010 .... The programme’s highly ambitious fiscal target—a narrowing of the budget deficit from around 31% of GDP in 2010 ... to less than 3% of GDP by 2015—does not seem achievable, given weak economic growth prospects in Ireland and in the euro zone.”

3. “Investor sentiment towards Ireland improved from mid-2011, paving the way for a gradual return to the financial markets for funding since July 2012, but economic conditions remain highly challenging. Future auctions, especially of long-term bonds, will remain vulnerable to spillover effects from the euro zone crisis.” “[D]ebt will reach a peak of around 130% of GDP towards the end of the forecast period, from an estimated 118% at end-2012.” EIU no longer thinks a haircut is possible, so some other change may be necessary.
4. There are political tensions within the coalition over fiscal policy.

**Bottom Line: Ireland initially engaged in extreme financial rescue, partially counteracted by austerity in other areas. A loss of market access then led to extreme overall austerity. This was followed by continued austerity to comply with the conditionality of the IMF/EU bailout. Conditionality remained central through the end of the analysis period.**