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The role of spending rigidity in fiscal adjustment

Luiz de Mello, Joao Tovar Jalles / 12 Mar 2026

Public debt is at or near record highs in many economies. This column argues that the composition and flexibility of government spending are as important as its size. Using cross-country data, it shows that higher spending rigidity (captured by the wage bill) reduces the sensitivity of cyclically adjusted primary balances to higher debt and reduces the likelihood of entering a consolidation episode. Instead, higher rigidity is associated with larger cuts to public investment. To improve flexibility, it suggests governments should strengthen payroll management, integrate staffing plans into medium-term fiscal frameworks, and make hiring and remuneration policies more transparent.

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Public debt is at or near record highs in many economies, at the same time as population ageing, climate change, and defence needs are putting pressure on government finances. General government gross debt is now around 112% of GDP among OECD countries, more than 40 percentage points above its pre-2008 average (OECD 2025). Many emerging-market economies and low-income countries are at high risk of, or already in, debt distress.

The traditional debate about fiscal consolidation focuses on whether adjustment should rely on spending cuts or tax hikes, and whether it is better to target current spending, investment, or revenues. A long line of empirical work – pioneered in the 1990s by Alberto Alesina, Roberto Perotti, and others (e.g. Alesina et al. 2019) – has shown that expenditure-based consolidations tend to be more durable and less

damaging to growth than tax-based ones, especially when they protect public investment. Yet this literature largely takes the structure of spending as given and pays relatively little attention to how rigid that structure is in practice.

A key message from the paper underpinning this column (de Mello and Jalles 2026) is that the composition and flexibility of spending are just as important as its aggregate size. When governments are locked into large and sticky wage bills, their room for manoeuvre shrinks, and the way they consolidate can end up undermining the very growth prospects that would help stabilise debt (Pina et al. 2026, Piguillem and Riboni 2024, IMF 2025).

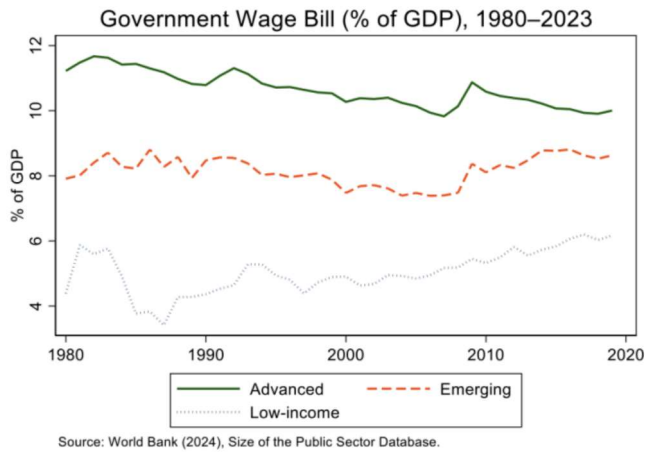
The wage bill as a source of rigidity

Across the OECD, the government wage bill has hovered around 10% of GDP and roughly one-fifth of total employment, showing only limited reaction even to major shocks such as the global crisis and the pandemic (Figure 1). In many countries, public-sector workers are relatively well paid and strongly protected, making it politically costly to cut pay or jobs even in the face of mounting fiscal pressure. Emerging-market economies and low-income countries typically have somewhat smaller wage bills as a share of GDP.

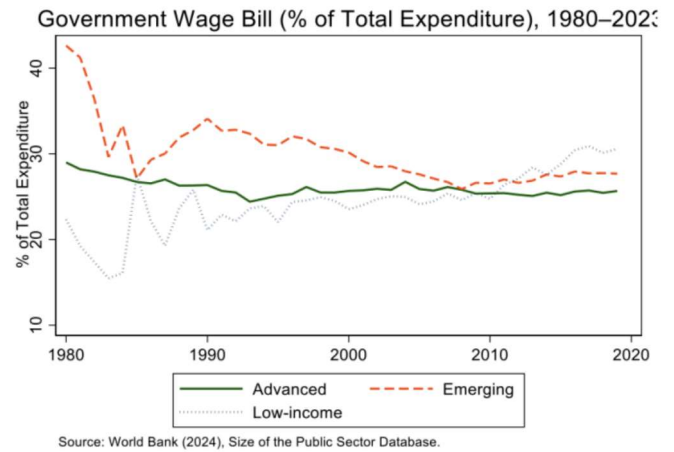
Using new World Bank data on government wage bills and public employment, we document that these items are highly persistent and adjust only sluggishly to macroeconomic conditions. A dynamic panel approach along the lines of Fatás and Mihov (2006) shows that the wage bill and public employment adjust only slowly to macroeconomic conditions, even after controlling for debt.

Figure 1 Stylised facts on the government wage bill

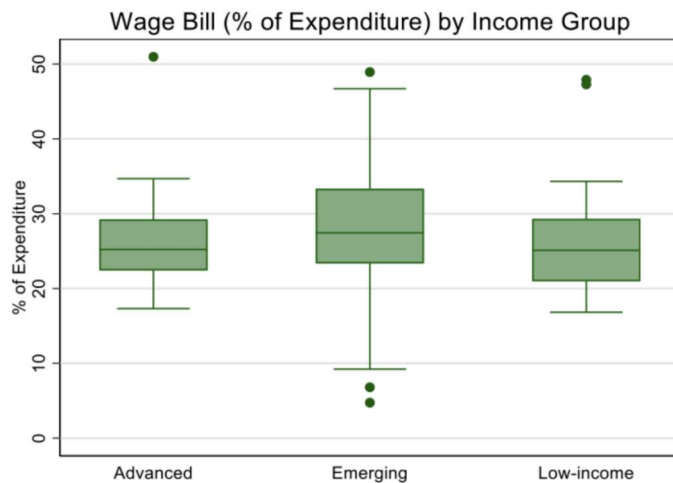
A) Government wage bill, 1980–2023
(% of GDP)



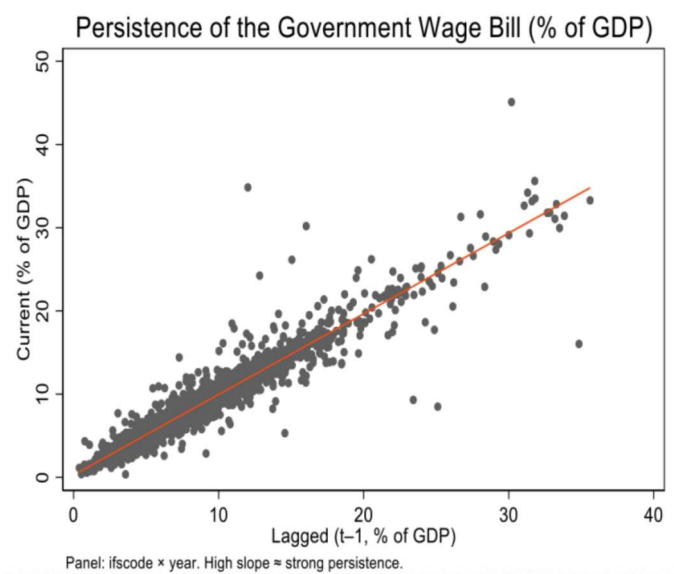
B) Government wage bill, 1980–2023
(% of total expenditure)



C) Distribution of wage bill by income group
(% of expenditure)



D) Persistence of the government wage bill (% of GDP)



Notes: Panels A and B plot the evolution of the government wage bill as a share of GDP and total expenditure, respectively, averaged across advanced, emerging, and low-income economies. Panel C reports the cross-country distribution of the wage bill-to-expenditure ratio by income group, while Panel D shows the relationship between current and lagged wage bill levels, illustrating persistence. Country classifications follow the World Bank income groupings as of 2023. All variables are expressed as percentages and averaged over available years between 1980 and 2023. The data are drawn from the World Bank (2024), Size of the Public Sector: Government Wage Bill and Employment Database.

How rigidity weakens fiscal adjustment

We embed spending rigidity in a simple fiscal reaction framework. Governments seek to stabilise debt by adjusting the cyclically adjusted primary balance (CAPB) in response to higher debt ratios, but only a fraction of spending is flexible enough to adjust in the short run. When the rigid share of spending – captured by the wage bill – is large, the effective response of the CAPB to higher debt is weaker.

This mechanism is tested in a large panel covering advanced, emerging-market economies, and low-income countries over 1980–2023. The main empirical finding is that governments do react to rising debt, but countries with higher wage-bill ratios deliver smaller improvements in the CAPB when debt rises. The effect is economically strongest in emerging-market economies. These findings are robust to alternative definitions of fiscal adjustment, sample restrictions, and an instrumental-variable strategy addressing possible endogeneity of the wage bill.

Spending rigidity constrains not only how much countries adjust but also whether they adjust at all. Using a global dataset of consolidation episodes defined by statistically significant CAPB improvements, estimation of the probability of consolidation shows that higher wage-bill-to-GDP ratios are associated with significantly lower odds of entering a consolidation episode, even after controlling for growth, inflation, debt, and exchange rate conditions.

Adjustment by cutting what is easiest, not what is best

If wages and other rigid items are hard to cut, where does consolidation come from? The paper finds that higher wage bill ratios are associated with larger cuts in public investment during consolidation, while the relationship with other flexible spending is weak and generally insignificant. This pattern is particularly pronounced outside advanced economies. The result is consolidation that may close short-term gaps at the cost of undermining long-term growth, infrastructure quality, and resilience.

Notably, there is little evidence that governments systematically compensate for rigid expenditure by leaning more on the revenue-raising measures to support consolidation. Across tax categories – personal and corporate income taxes, VAT, and trade taxes – the wage-bill ratio does not significantly predict discretionary tax changes.

Politics: Cohesion helps, but rigidity still bites

Fiscal adjustment is shaped not only by economics but also by politics. Countries with more cohesive legislatures (less fragmentation) deliver stronger discretionary fiscal adjustment, consistent with lower coordination costs and fewer veto players, but even cohesive governments struggle to consolidate if much of spending is locked in.

Turning to ideology, left-leaning governments are somewhat less inclined to consolidate in the face of rigidity, and when fiscal space allows, they tend to protect or even expand capital spending more than right-leaning ones, though this investment bias is itself constrained by the size of the wage bill.

Policy lessons: Creating fiscal room without undermining growth

Improving spending flexibility does not mean indiscriminate wage cuts or hiring freezes, which can damage state capacity and service quality, especially where baseline staffing is already thin. Instead, governments can strengthen payroll management, integrate staffing plans into medium-term fiscal frameworks and make hiring and remuneration policies more transparent. They can also use targeted attrition, redeployment, and performance-based pay to align public employment with policy priorities without abrupt across-the-board cuts. Moreover, they can review mandates and programmes regularly, using institutionalised spending reviews to weed out low-value expenditure and limit the proliferation of quasi-permanent ‘temporary’ measures.

Fiscal frameworks and rules would do well to take rigidity explicitly into account. Expenditure rules that focus on growth rates of flexible spending, rather than aggregate envelopes that include rigid items, can help guide adjustment toward more sustainable compositions, prompting earlier and more gradual reform rather than sudden, pro-cyclical cuts (Darvas and Wolff 2022).

Strengthening public investment management – from project appraisal and selection to implementation and ex-post evaluation – can raise the quality of spending and make the case for safeguarding investment envelopes more compelling. Where fiscal space is tight, rebalancing within capital budgets toward maintenance and high-return projects can help avoid the hidden liabilities created by deferred upkeep.

Political economy reforms that foster legislative cohesion and credible commitment can amplify the benefits of greater flexibility. Clear medium-term fiscal strategies, independent fiscal councils and transparent communication about the costs of inaction can all help build support for gradual, rules-based adjustment.

Turning the tanker before the next storm

Fiscal sustainability is not just about how big the state is, but about what it spends on and how easily it can adjust. Large and rigid wage bills weaken the response of fiscal policy to rising debt and tilt consolidation toward cuts in public investment, especially in emerging and low-income economies. Political cohesion can mitigate, but not eliminate, these constraints.

In a world where the next shock may not be far away, governments that invest in more flexible spending structures, stronger fiscal institutions and better protected investment will be better placed to turn the fiscal tanker in time – and to do so without scuttling long-term growth. Designing fiscal frameworks that explicitly account for spending rigidity will therefore be critical for achieving durable and growth-friendly debt stabilisation in the years ahead.

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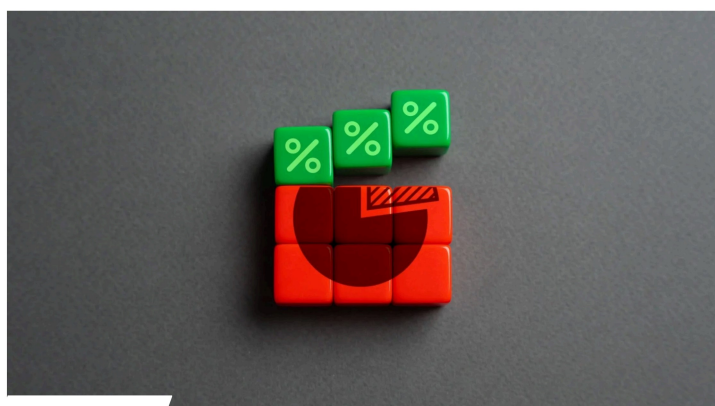
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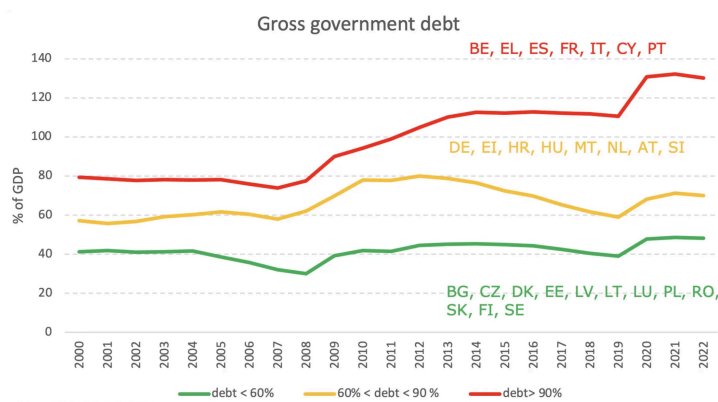


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