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Crisis Budgeting

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Budgeting is fundamentally altered, if only temporarily, by pressures that overwhelm established policies and practices. This article discusses conventional and non-conventional responses to crisis, and how crisis impacts on the budget process. Just as crisis has mobilised governments to take global actions that spill beyond national boundaries, the aftermath of crisis will spur them to harmonise and integrate budget policies that affect the international financial system.

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The global financial crisis and the extraordinary governmental and international responses give rise to fundamental questions that go to the core of budgeting as the authoritative process for allocating public money. One set of questions pertains to the types of stimulus and bailout programmes that have been devised by national governments; another pertains to the impact of crisis on the conduct of budgeting. The first set of questions considers how budgeting shapes, or fails to shape, emergency revenue and spending actions; the second set considers how crisis affects the machinery of budgeting. The first set focuses on substantive policies, particularly on responses that deviate from conventional budget practice; the second set focuses on budgetary roles and procedures.

Section 1 of this article addresses substantive adjustments in budget policy; Section 2 deals with changes in the conduct of budgeting. The article is premised on the notion that budgeting is fundamentally altered, if only temporarily, by pressures that overwhelm established policies and practices. Emergencies "stress test" the entrenched routines that regulate budgeting in normal times. Business-as-usual budgeting is a stabiliser of government policy and a routiniser of public management that thrives when underlying political and fiscal conditions are stable. When they are not, budget makers may have difficulty managing the frenzied, largely unstructured and improvisational rush for decisions, and effective power may migrate from those who run the process to those who manage the crisis. In some circumstances, budgeting might be shunted aside, its main role confined to tallying the fiscal impacts of decisions taken elsewhere. When this occurs, the formalities of budgeting survive but the process is undermined by the *force majeure* of crisis.

A persuasive case can be made for adopting extraordinary measures to cope with immediate or long-term crisis. Arguably, the modulated cadences of budgeting – small adjustments made according to fixed procedures and schedules – should not be allowed to block forthright action. When crisis strikes, political leaders feel impelled to act, even if doing so temporarily bypasses or disables the budget process. But actions taken in response to extraordinary challenges can have lingering impacts on administrative practices as well as on the government's fiscal position long after the special circumstances have passed. Abnormal policies or instruments contrived to cope with crisis might be deployed to very different ends years later. For example, extrabudgetary accounts introduced to inject money into the economy might become precedents for non-crisis ploys when the government of the day wants to evade budget controls.

Section 1 discusses conventional and non-conventional types of actions. The term non-conventional includes various funding mechanisms that are outside the normal spending patterns of budgeting. Section 2 focuses on the impact of crisis on the budget process. It argues that crisis affects four salient elements of budgeting: the routines and procedures used to allocate and spend money; political and managerial roles of participants in the process; incremental norms and behaviour; and the management of budgetary conflict. Although national governments have differed in their responses to the crisis, the discussion will be fairly general.

The concluding section reflects how budgeting might be affected in the future when the crisis abates and governments strive to normalise public finance. The central idea is that, just as crisis has mobilised governments to take global actions that spill beyond national boundaries, the aftermath of crisis will spur them to harmonise and integrate budget policies that affect the international financial system.

1. Budgetary responses to crisis

The budgets of all OECD countries are engineered to respond to shifts in economic conditions by means of built-in stabilisers that automatically increase or reduce revenues, expenditures and the fiscal balance when the economy expands or contracts. In all countries, the response is much stronger on the revenue side of the budget than on expenditures. The magnitude of response varies among countries and depends on the structure of the tax system, the types of income support programmes, and other conditions.

Automatic stabilisers are both the first response and an early warning of shifts in critical economic indicators. They alert a government to the prospect that the budget approved for the year under way or planned for the next year will likely diverge from its projected course. When economic news is favourable and revenues surge above budget, the government can opt to spend the bounty by enhancing programmes or trimming taxes. Alternatively, the government can retain the additional revenue and thereby reduce the deficit or increase the surplus. The same set of options pertains when the economy shrinks, but with two important caveats: *i)* when the downturn is severe, inaction might not be a viable option; and *ii)* if the government has difficulty managing fiscal imbalances, it might be impelled to adopt austere budget policies even when the economy is contracting.

In relatively mild recessions, a government may rely solely on automatic stabilisers to stimulate economic activity, or may take discretionary actions that add some expenditure or subtract some revenue within the framework of established budget policy. However, the massive stimulus programmes promoted to deal with the current crisis indicate that modest tinkering with revenues and expenditures is not deemed sufficient when major financial institutions are on the brink of collapse and both consumers and entrepreneurs have lost confidence in the self-correcting capacity of markets. Moreover, with soaring budget deficits, governments may prefer to rely on extrabudgetary instruments that mask a portion of the liabilities they are accumulating. Although all stimulus packages have contained tax cuts and spending increases that are recognised in budget statements, some large packages have also made use of loans, guarantees, extrabudgetary entities and central bank operations that generally are outside the ambit of the budget. The paragraphs that follow discuss the budgetary treatment of conventional and non-conventional instruments and the financial risks they generate. In effect, each type of non-conventional instrument substitutes risk for direct budget action. By taking on more risk, governments strive to purchase more stimuli and to restore confidence in financial institutions.

1.1. Grants

When the economy deteriorates, governments often provide stimulus through grants to households and (less frequently) enterprises. Facing crisis, governments may also give funds to financial institutions and operating firms to keep them afloat. These straightforward grants are recorded as expenditures in the fiscal period in which they are disbursed, and they do not differ (except possibly in volume) from numerous other conventional grants included in public budgets. Sometimes, however, a government acquires assets in exchange for grants (or non-conventional assistance, discussed in ensuing paragraphs). In recapitalising financial institutions, governments sometimes acquire an equity position; in bailing out operating firms, they may become *de jure* or *de facto* owners. This situation gives rise to the question of how a government should handle transactions in which it acquires assets in exchange for grants. In commercial accounting, funds disbursed to acquire assets are not expensed, but they may be in governmental cash accounting practices.

A further complication arises when the acquired assets are difficult to valuate. Governments typically are not bound by fair accounting rules that require assets and liabilities to be marked to market, but governments still have to enter some value in financial statements. However, they may choose to disregard the assets in budget statements. Doing so would conform the treatment of these transactions to government disbursements for road construction, school buildings, and other asset-purchasing activities. There is one big difference between grants whose sole purpose is to acquire public assets and crisis situations where the acquisition of assets is a byproduct of efforts to assist private entities. In the former situation, governments generally retain ownership throughout the life of the asset; in the latter case, governments may sell acquired assets when the firm recovers or to divest owned enterprises. Doing so would give rise to the question of whether proceeds from asset sales should be budgeted as receipts, offsets to expenditures, or as means of financing.

1.2. Loans

There are numerous circumstances when loans, rather than grants, are an efficient form of government assistance; some of these have been present during the current economic crisis. For example, loans may be the preferred form of assistance for viable firms that have been cut off from credit because of turmoil in financial markets, or for firms that need credit to expand or invest in new technologies. But loans raise a number of issues that depend on how they are accounted for in the budget. Some countries that have cash-based budget systems record loans as “below the line” – that is, the cash flows associated with them are not consolidated into the budget’s statements of revenues and expenditure. This approach has the virtue that it distinguishes between loans and grants, and avoids some distortions (discussed in the next paragraph) in budget accounts that occur when loans are treated as outlays. However, some countries that have cash-based budget systems record the full amount of each loan as an outlay. They disregard key factors that determine the actual cost of loans, including the risk of default, the interest rate charged borrowers, whether the loans are collateralised, and repayment terms. When cash budgeting treats loans as equivalents to grants, it discourages governments from using loans to evade budget controls or to portray their fiscal position in a more favourable light.

But accounting for loans as disbursements has serious drawbacks. When it books the full amount of a loan as an outlay, a government forgoes recognition of loss if the loan is forgiven or defaulted. It cannot record the same expenditure twice – when the loan is made, and when the loan is not repaid. Thus, by overstating the loan's cost at the outset, a government is compelled to understate the cost later on. This anomaly opens the door to moral hazard, with borrowers and governments having strong incentives to turn loans into grants without having to show any cost for the conversion.

To make matters worse, the issuance of loans and the incidence of loss almost always occur in different time periods, making it difficult to record the net cost to government in annual financial statements. An additional problem is that the cash basis requires governments to record loan repayments as revenue or as a reduction in expenditure, even when they do not charge interest or give borrowers concessionary rates. The true cost to government is not recognised in budget statements.

The optimal solution is to apply the accrual basis to the government's loan portfolio, even if the rest of the budget is maintained on the cash basis. Governments would treat loans as receivables, as an exchange of one asset (cash) for another. Only estimated or actual losses would be expensed in the budget. This method would enable governments to distinguish between low and high-risk borrowers, as well as between collateralised and non-collateralised loans. A variant of this approach has been applied by the United States since the early 1990s. It records the "subsidy cost" of loans as expenditures. This cost is defined as the net present value of estimated future cash outflows (loan disbursements) and inflows (repayments of principal and interest, and recoveries pursuant to default). The discount rate is set at the interest rate paid by the government on its borrowings. Thus, any concessionary rate below its cost appears as a subsidy cost.

It is quite difficult to estimate future losses that might derive from massive loans issued during the current economic emergency. These loans concentrate rather than pool risk, and actual losses may depend as much on the future performance of the economy as on the credit-worthiness of particular borrowers. When a government makes a large number of small loans, it needs only to estimate the probability of default for the entire portfolio; it does not have to estimate the probability for each borrower. But when very large loans are made to a small number of borrowers, as has typically been the case in recent stimulus/bailout programmes, pooled-risk models do not work. Instead, governments must assess the risk inherent in each type of loan. However, most of this risk is systemic, and estimates of future losses depend on economic trends and government policies which are hard to project during the malaise that grips OECD countries.

1.3. Guarantees

In contrast to loans, guarantees do not entail any disbursement at the outset. But similar to loans, guarantees transfer risk to the government because there is some probability that the government will have to make payment in case of future default. Guarantees are not unique to crisis situations. Many governments guarantee bank deposits, the price of agriculture products, home mortgages, student loans, and other risks. In crisis, however, governments have also guaranteed the debt of financial institutions and major enterprises. These risks tend to be concentrated, making it difficult to measure the government's exposure.

Under conventional cash accounting rules, the government does not recognise any risk when it issues guarantees, nor does it have to record these transactions in the budget. For these reasons alone, guarantees are an attractive form of intervention; governments can assist enterprises without incurring an immediate cost. Guarantees may also be attractive because they entail less involvement by the government and may boost confidence in financial institutions at a time when markets are depressed and entrepreneurs are wary of taking on additional risk. When the government guarantees debt, lenders need only be concerned about the quality of the guarantee; they do not have to be concerned with the credit-worthiness of borrowers. There is a tendency, therefore, to provide guarantees to high-risk borrowers who would not otherwise be able to obtain credit.

During the current crisis, governments generally have issued explicit guarantees that spell out their financial obligations in case certain adverse events occur. But governments may also incur implicit liabilities that arise out of strong expectations of how it will act in adverse circumstances. For example, some governments limit the amount of individual bank deposits that they indemnify against loss, but nevertheless cover the full value of deposits when banks fail. Similarly, some governments of OECD countries have assisted financial institutions deemed "too big to fail" because of fear that the economy would be vulnerable to systemic breakdown if they did not intervene. Implicit liabilities are difficult to provide for in the budget, or other financial statements, because doing so would convert them into explicit liabilities and would encourage morally hazardous behaviour, such as depositors shifting funds to high-risk institutions which promise higher returns. On the other hand, ignoring implicit liabilities would greatly understate the government's exposure to financial risk.

Conventional budgets are deficient in measuring and controlling both explicit and implicit guarantees and similar contingent liabilities. One obvious shortcoming is that they have an inadequate time frame – one year in countries that have only annual budgets, three to five years in countries that budget within medium-term fiscal frameworks. These time frames are too short for the downstream risks taken by governments when they guarantee debt, commit themselves to indemnify depositors against losses, or promise to compensate bondholders or others for shortfalls in the financial performance of enterprises.

As already noted, conventional budgets record cash flows; they do not account for the risk inherent in contingent liabilities. Because budgets record cash flows rather than liabilities and short-term payments rather than long-term risks, politicians have incentive and opportunity to assist enterprises and financial institutions in ways that hide the true cost, leading to actions that may worsen future fiscal conditions. When governments create fiscal illusions, firms and households behave in morally hazardous ways, and fiscal risk escalates.

Crisis is not the most opportune time for establishing new means of regulating guarantees and similar fiscal risks. The impulse is for the government to act quickly and boldly, even if that means throwing caution aside or remaining blissfully ignorant about future costs. Nevertheless, the scale of government intervention and the enormous risk to its fiscal position strongly indicate that the current economic crisis should give rise both to new forms of government assistance and new forms of fiscal control.

The first essential step is for the government to be transparent about the types and quantity of risks it is taking, and to assess the probability that it will be called upon to make good on its portfolio of contingent liabilities. Once it has adequate information on existing and prospective contingent liabilities, the government can incorporate decision risks into ongoing budget procedures. Doing so would enable it to compare the costs and benefits of grants, loans, guarantees and other forms of assistance without biasing decisions in favour of one or another type. However, not all risks can be managed through the budget. One problem is that the budget is not a suitable instrument for managing implicit risks; another problem, elaborated in the next section, is that normal budget procedures tend to be shunted aside when crisis strikes.

The best – and sometimes the only – opportunity for effectively managing contingent liabilities is to limit the risks arising out of guarantees before they are taken. Ideally, the government would establish criteria for determining whether to issue guarantees or enter into other contingent commitments, and it would withdraw from risks that do not meet minimum standards. Unfortunately, pressured governments usually do not have the time or inclination to undertake these assessments when confronted by systemic failure. In bad times, governments take on risks that they would reject during good times.

1.4. Extrabudgetary entities

In many OECD countries, the crisis has impelled governments to take on business-like activities, such as managing assets and liabilities, running or taking responsibility for financial institutions, and issuing financial statements that conform to commercial accounting standards. These tasks are not ordinarily performed by government agencies. In some circumstances, it may be appropriate to entrust them to a special entity that functions as a state-owned enterprise whose receipts and expenditures are not included in the budget. The government may capitalise the entity or guarantee its debt, and authorise it to assume the assets and liabilities of insolvent or failing enterprises. Although the state is liable for losses, the special entity has operating freedom and is not subject to conventional budget and administrative controls.

Although governments may have legitimate reasons for establishing special entities, it may also use them to shift disbursements, risks or losses off the budget. The government can give any entity extrabudgetary status, even when it is carrying out tasks usually entrusted to government agencies. Once established, extrabudgetary entities often have far greater operating independence than is accorded regular agencies, especially when they generate their own income through trading activities or from special accounts. They may gain exemption from civil service and procurement rules, and may escape periodic scrutiny through the budget process and have broad discretion in spending available funds. In effect, they function as special enclaves that operate apart from the administrative machinery of government.

Extrabudgetary entities created to deal with crisis-induced policies may survive after the crisis has passed, particularly if they still have a portfolio of assets and earmarked sources of revenue. Even when they are not self-financing, these entities may succeed in building political support that enables them to retain off-budget status and to draw on special funds set up to keep them in business. They may take on new responsibilities that allegedly enable the government to benefit from the expertise acquired in managing crisis-related policies. Possibly, at some time in the future, the government will launch a drive to rationalise public finance and uproot some extrabudgetary entities and special funds.

1.5. Central bank fiscal activities

With national budgets stressed and imbalanced by sharp falls in revenue and surging expenditures, some governments have turned to the central bank to participate in stimulative efforts. Their legal independence notwithstanding, central banks may be pulled into the whirlpool of government efforts to forestall economic collapse. Three types of condition may induce central banks to undertake quasi-fiscal activities in close co-ordination with government:

- The interest rate at which the central bank lends to private banks is at or close to zero, depriving it of this standard tool of economic management.
- Credit markets are frozen or illiquid, blunting the stimulative effect of government fiscal actions.
- There is concern about the capacity of private lenders to finance the surge in public debt.

In these circumstances, the central bank may itself purchase government debt, or go even further and purchase private debt such as home mortgages and credit card debt. This quantitative easing might stoke inflation in the future but, like other crisis-driven activities, its focus is on the short term. Their swollen balance sheets are a problem that will have to be confronted when crisis abates. The ease and manner in which they unwind positions will have a lot to do with the future fiscal health of countries that have taken this course.

The fiscal activities of central banks are similar to those of extrabudgetary entities. Like extrabudgetary entities, the finances of the central bank are outside the ambit of the budget; and, like extrabudgetary accounts, the central bank has its own source of funding. But there are two big differences. One is broad acceptance of the principle that central banks should be sufficiently independent to manage the country's monetary position free of undue political influence; the other is the capacity of the central bank to create money. When they engage in quasi-fiscal activities, central banks compromise their claim for independence, and when they take risks on their balance sheets, central banks place risks on future governments.

2. How crisis budgeting differs

Crisis budgeting alters four linked features of conventional budgeting. First, special procedures that override the embedded routines of budgeting are improvised to expedite action. Second, effective budget power migrates from entrenched players to others, typically from specialised power holders who manage the process or guard their particular interests to political leaders who have a broader portfolio of policy concerns. Third, crisis budgeting deviates from incremental patterns and generates significantly larger changes in revenue or spending outcome than would ensue from regular budget practices. Finally, as a byproduct of the foregoing deviations, crisis budgeting alters the way the process manages conflict. When budgeting shifts to crisis mode, established ways for regulating conflict are weakened, but new ones must be contrived. Each of these adjustments is discussed in the subsections that follow.

2.1. Procedures

Budgeting is the routinisation of choice. It assigns roles and responsibilities to offices in both the government and the legislature, as well as to different niches in the administrative hierarchy, along with forms specifying the information to be supplied and reviewed and deadlines for each step along the way. Participants do not have to invent new routines each year because budget procedures typically are carried forward from the previous year with little or no change. Routines stabilise expectations and relationships, give budget makers advance notice of what they must do to navigate through the process, and simplify the enormously complicated tasks of compiling and implanting the budget. Budgeting is sedated by the many forms that have to be completed and reviewed, as well as by the need to make numerous decisions within unyielding time frames.

Budgeting's routines also tend to crowd out fresh data and options provided by related processes such as national planning, programme evaluation, and policy analysis. From time to time, national governments try to inject more analysis or evaluation into the process by overhauling budget routines and introducing new classifications or information requirements. Frequently, the short-term impact of major budget process reform is to disorient participants and delay the implementation of new systems. It takes time for new routines, along with associated behavioural changes, to become embedded in the process. By the time they do, ambitious reforms may have been watered down, and the reformed process becomes more an amalgam of old and new than a complete departure from the past.

The fixed budget calendar is the greatest casualty of crisis. Faced with pressure to act, governments cannot wait until the next cycle. As crisis deepens, one emergency package supersedes or adds to the previous one and is assembled even before the previous response has been fully implemented or its impact studied. A generation ago, Caiden and Wildavsky (1974) demonstrated that, the poorer a government is, the more budgets it has during the year. Similarly, the deeper the crisis, the more budgets the government prepares. Crisis budgeting is inherently improvisational. Rules and procedure are devised to accommodate the needs of the moment, and frequent adjustments are made along the way. *Ad hockery* is necessary because established procedures get in the way of dealing with the crisis, and new players are brought into the process.

Along with bypassing the fixed calendar, crisis budgeting shortcuts through the maze of budget procedures. Routinised budgeting is a vast machinery for compiling and sifting information on costs, activities, spending units, workloads, constituencies, legal requirements and other factors that culminate in authoritative decisions. In most countries, spending agencies gather the information, consolidate it into prescribed form, submit it to the finance ministry or budget office, negotiate spending amounts, and reach decisions which are then formatted into budget statements. In crisis budgeting, the process may be reversed, with policy makers at the centre of government deciding the types and scope of action before reviewing bids from spending units. In some cases, these units have to decide how to spend the money after they are informed of how much they will be given.

Procedures for implementing the budget may also be affected by crisis, particularly in countries where spending units have itemised budgets or are regulated in the amount that may be spent each month or quarter of the fiscal period. Crisis loosens these constraints and gives agencies greater flexibility in spending emergency funds. In fact, agencies may be prodded to spend at a faster than normal pace in order to ensure that the stimulus is timely.

2.2. Power

Improvisation may open budgeting to new participants and close it to others. It thereby has the potential to redistribute budgetary power. As noted, fixed routines assign fixed roles to those who make and review budgets; uprooting routines is thus an essential step in transferring effective power to others. In normal times, budgeting is the fiefdom of claimants for resources and guardians of the public purse. While claimants and guardians have adversarial roles and often quarrel over budget allocations, they typically have a year-round, interdependent relationship. Claimants have better information on programme impacts and the operational effectiveness of government agencies; guardians have control over the money. Each side plays its expected role during the budget cycle: claimants ask for more money; guardians usually give them more, but less than was requested. If the players and their routines do not change, the probability is that outcomes will not change either, which would defeat the purpose of putting the process on a crisis footing.

Crisis budgeting tends to be more top-down and centralised than ordinary budgeting. The size of the stimulus is a critical decision for power holders at the centre; they set the framework before reviewing sectoral claims. Centralisation expedites the process, invests political capital and urgency in mobilising support, and marginalises those who stand in the way. Inasmuch as crisis budgeting lacks the action-forcing deadlines built into the regular budget calendar, political leaders must generate their own pressure to keep the process moving along.

Crisis changes the balance of power between claimants and guardians. When deficit reduction is the order of the day, processing the budget in crisis mode strengthens guardians. Not only can they thwart new claims, but they can also trim existing programmes, a feat that is exceedingly difficult in ordinary times. But when crisis impels the government to boost spending, the reverse occurs and claimants gain advantage. This "it depends" tendency is indicative of one of the enduring characteristics of budgeting: it can be moulded to accommodate whatever results politicians want. Crisis makes it easier for them to write their preferences into the budget, but even in normal times the budget process serves its political masters.

2.3. Outcomes

Normal budget outcomes are incremental; the routines managed by budget specialists are engineered to produce allocations that deviate only marginally from those generated in previous budgets. Crisis budgeting, by contrast, is non-incremental; it produces spending patterns that may be disconnected from the past. If it did not, the government's response to crisis would likely be inadequate. It is highly probable, however, that after the crisis passes, budgeting will revert to incremental patterns. After all, if more than half a century of reform efforts to dislodge incrementalism from its dominant influence has not succeeded, temporary measures to deal with economic distress will not leave a lasting imprint on this feature of budgeting.

2.4. Conflict

Each of the accommodations to crisis discussed here has the potential to inflame budgetary conflict. Crisis budgeting mitigates conflict by imposing its own action-forcing deadlines that put a time limit on strife. Even when there is no formal deadline, the emergency mood impels swift action that overrides particularistic interests. In normal budgeting, cyclical routines deaden conflict by establishing preset procedures that do not have to be negotiated anew, stabilising roles and expectations, and establishing civil rules for containing and resolving budget disagreements. Participants do not have to fight over how decisions should be made, even though they may continue to bicker over what the decisions should be. Routinised budgeting enables those who have stakes in decisions to participate in making them. Of course, broad participation that enables every spending unit to bid for money has the potential to make the process more fractious, but incremental norms dictate that just about every claimant gets a share of the budget and of increased spending.

Normal budgeting calms the process by confining almost all outcomes to a relatively narrow, incremental band; crisis budgeting has the potential to arouse conflict because large changes are being made, and not every claimant will have a share. When crisis leads to decremental outcomes, as it did in some OECD countries during the 1980s, heightened conflict is inevitable. But when stimulus is the order of the day, the main issues in dispute are how big the increases should be and who should get them. These decisions may stir political conflict over the role of government, its fiscal policy and capacity to manage a rapidly rising debt load, and programme priorities but, because these types of decision are made at high political levels, they will not open up the bureaucratic infighting that often besets budgeting.

3. Post-crisis budgeting

Crisis passes, normalcy returns, and budgeting reverts to preset routines, stable roles, and predictable outcomes. This has generally been the pattern in the past; it may well prevail when the current crisis is over. Recent distress may spur some governments to strengthen or add a multi-year perspective to their budget work, or to bolster their capacity to analyse the interface between the budget and the economy. Undoubtedly, budgeting will continue to exhibit the restless tinkering with rules, procedures, informational requirements and other features of the process that has characterised reform for the past half a century. But in most regards, there will not be overwhelming pressure to remake budgeting.

In at least four ways, however, the current crisis may significantly impact budget practice. First, the crisis will leave many countries with elevated levels of public debt, in some cases far above widely accepted norms such as the 60% ratio to GDP specified in the European Union Stability and Growth Pact (SGP). Second, national governments will pay greater attention to questions of fiscal sustainability, which will induce them to expand time horizons beyond the medium term to cross-generational issues. Third, governments will seek new means to assess fiscal risk and to integrate risk estimates into the budget and other financial statements. Finally, the crisis and its aftermath will spur governments to co-ordinate some budget rules and policies.

3.1. Public debt

The massive stimulus packages – including grants, loans and guarantees – launched by some countries will boost debt burdens to record levels. Although debt-to-GDP ratios will likely recede when economic growth resumes, they will persist at well above pre-crisis levels for an extended period. The future volume of debt and the capacity of governments to finance it will depend on critical factors that cannot be easily foreseen, including future economic performance, the willingness of surplus countries to buy bonds issued by debtor governments, and the ability of fiscally stressed governments to increase taxes. But protracted pressure on debt-burdened national governments to constrain public expenditure can be foreseen. In some countries, budgeting will partly be a decremental process, with the government undertaking fundamental reviews of public expenditures and programme commitments. In some countries, the ideological divide between left and right on fiscal and budget policy will widen, with some groups demanding shrinkage of the state and others arguing for the government to retain or expand its enlarged scale. The technology and machinery of performance and results will more fully penetrate budget practice, though not necessarily with much greater success than past efforts.

3.2. Fiscal rules

Bloated debt and deficits will also spark renewed interest in fiscal rules that constrain governments. One possibility is that governments will simply extend the SGP and fiscal responsibility rules already in place, perhaps with somewhat tougher enforcement mechanisms. But another possibility would be for them to go back to their drawing boards and devise next-generation rules that do take account of structural and cyclical variations in fiscal performance. Perhaps some governments will come to recognise that the best time – maybe the only effective time – to enforce rules is when the economy is booming, revenues are plentiful, and the budget is at or near balance. It is typically during the good times that governments take on additional commitments that burden future budgets. They do so on the reasonable argument that the fiscal position is sound and it is prudent to spend available resources to enhance social goods. But this behaviour has greatly destabilised public finance in major OECD countries. It is telling that several countries with structural budget rules have fared relatively well during the current economic storm.

Emerging economies may derive their own lessons from the budgetary aftershocks of economic crisis. Some are likely to become quite cautious in expanding the government's commitment to pensions and other long-term obligations. The current crisis might embolden those who believe that the western way should not be their way, and that they should not scale up government to the level common in OECD countries. Others may conclude that they need sturdier tax systems, and that the existing revenue base does not suffice for the risks and responsibilities they may face in the future.

3.3. Sustainability

One of the critical limitations of fiscal rules is that they pertain to a single fiscal period, typically the current or the next year. Crisis is likely to add momentum to efforts that expand the government's fiscal horizon from one year or the medium term to the long term, and from questions of fiscal balance to the issue of fiscal sustainability. As discussed several years ago (Schick, 2005), sustainability has multiple dimensions, including intergenerational fairness and government solvency. In the light of crisis and the legacy of elevated debt levels, many national governments will be propelled to examine a third dimension of sustainability: whether they can keep to the current fiscal course, including tax rates and pension/health obligations. For them, the crisis could not have been more ill-timed, for it occurs as the long-predicted surge in elderly populations is under way or about to begin. Governments struggling to pay burgeoning health and pension costs must now add steeply rising debt service to the pressure on future budgets.

A number of countries currently publish long-term sustainability projections, and others are sure to do so in the future. These reports typically add to the stockpile of budgetary information, but they do not constrain current revenue and spending decisions. One should not be surprised if sustainability studies become integrated into budget work by constraining current decisions that are projected to adversely impact long-term sustainability. One way is to establish an intertemporal budget constraint that bars the government from action that would widen the present value of its fiscal gap. Alternatively, governments could measure their fiscal position on a balance-sheet basis and constrain revenue or spending decisions that reduce net assets or increase net liabilities. A strong case can be made that a fiscal sustainability rule should cover revisions in the long-term fiscal outlook that arise out of new policies; it would not cover revisions due to projected shifts in economic conditions, increases in the cost of health care or other public services, or those resulting from demographic trends.

Embedding sustainability analysis and constraints in the budget process will occur over an extended period and new methods will have to be devised and tested, with a few pioneering governments taking the lead and others following when the innovations have gained wider acceptance. The diffusion of this innovation would be accelerated if the International Monetary Fund were to incorporate sustainability projections and analyses in future versions of its *Code of Good Practices on Fiscal Transparency* (IMF, 2007). But given the difficulties that have beset efforts to enforce fiscal rules that span only a single year or the medium term, governments are likely to be cautious in building sustainability rules into their core budget practices.

3.4. Fiscal risk

As the risk holder of last resort, national governments have been profoundly affected by the steep economic decline and collapse of major financial institutions. Risks that appeared to be costless in good times have come due under adverse conditions that have added greatly to budget distress and have bedevilled efforts to stabilise public finance. Future governments will likely act to strengthen risk management by compiling and publishing information on contingent liabilities and other risks, either as supplementary schedules to financial statements or as annexes to budget documents. Some will establish independent risk assessment offices with authority to override risk taking by sectoral agencies. Some will apply the accrual basis or similar techniques to measure and budget for the government's exposure.

Beyond these sensible moves, it may be appropriate for national governments to rethink policies and actions that put them in harm's way. A useful starting point would be explicit recognition that all risks have costs and that systemic risks are the most costly type. If risks did not have costs, beneficiaries would have no incentive to shift them to the government. Regarding every risk as a cost would entail accounting standards that recognise the cost, budget rules that regulate them, administrative practices that apply tough criteria in determining whether to take the risks, and politicians who protect the public interest.

Recognising the risk arising out of systemic breakdown is sensitive because it involves both explicit and implicit risks and may lead a government to more actively regulate financial markets and other sources of risk. In the current crisis, much of the cost assumed by governments has been implicit in the operation of national financial systems. The "too big to fail" mindset has induced governments to provide massive assistance to distressed banks; concern over a collapse in consumer demand or potential political unrest has spurred governments to indemnify depositors for all losses. The enormous cost of implicit contingent liabilities will almost certainly leave in its wake new regulatory regimes; it may also lead governments to put private risk takers on notice that they should not expect the same level of public protection in the future as they received in the past.

3.5. International co-operation and enforcement

The final – and potentially most far-reaching – adjustment may be in the architecture of cross-national financial management. In a paper written for the 25th Meeting of Senior Budget Officials (Schick, 2004), this writer foretold of a future when the SBO has become a standard-setting body for budget practices. The unfolding financial crisis may well accelerate this development. National governments have become more acutely aware of their financial and fiscal interdependencies, and of contagions that spread globally from their initial sources to other venues. Recent meetings of the G7 and the G20 have demonstrated both professed commitment to co-ordinated action and difficulties in acting in a concerted manner. Future meetings of these and other groups will grapple with the issue of how to adjust national practices to facilitate international co-operation.

The initial efforts in building international capacity may focus on information sharing, early warning systems, accounting standards, and voluntary efforts. When, as likely, these prove inadequate, national governments will be pressured to agree to stronger co-ordination measures. Over time, global rules and standards will emerge for various features of budgeting and other elements of public financial management. The last redoubt of national budgetary independence will be substantive policy, but even this critical aspect of state sovereignty may be undermined by crisis.

The internationalism of budget procedures and policies will unfold over an extended period. In the paper celebrating the 25th Annual Meeting of Senior Budget Officials (Schick, 2004), this writer mirthfully foretold of the 50th Meeting which will be convened to promulgate new budget rules. The deep financial crisis that has challenged national budgets suggests that governments might not have to wait that long for the future to arrive.

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