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## **Fiscal Risks, Fiscal Sustainability and Rethinking Fiscal Rules**

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This paper was prepared by Joseph J. Minarik.

For further information, please contact:  
Jon BLONDAL ([jon.blondal@oecd.org](mailto:jon.blondal@oecd.org))

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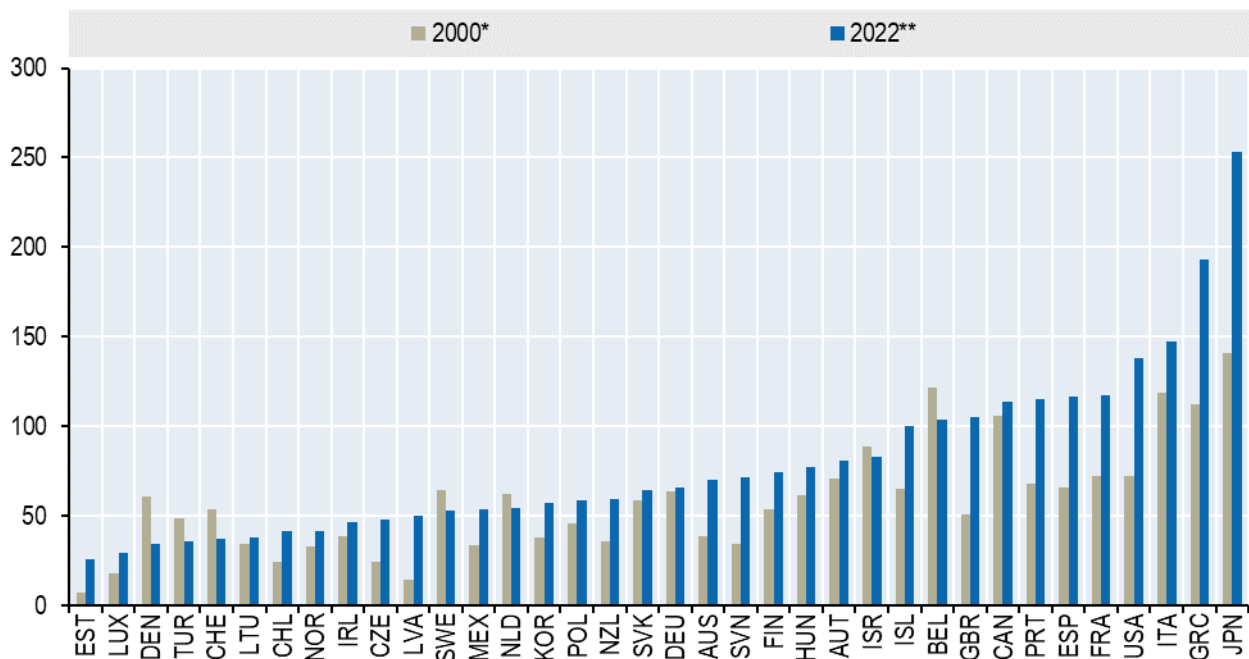
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# Introduction

1. Since the turn of the millennium, a succession of adverse events around the world has worsened fiscal positions to a degree not long before unthinkable.
2. Following an extraordinary decade of significant economic growth, generally smaller fiscal deficits and even budget surpluses in some countries, the late 1990s left an aura of stability and prosperity, suggesting an “end of history” for macroeconomics in addition to the geopolitical calm many enjoyed.
3. But then, a widely shared economic downturn, followed by a housing bubble and resultant financial shock, visited upon the first decade of the new century. And then a decade of only partial fiscal recovery was capped by the virulent global pandemic, which disrupted trade and commerce, and imposed its own direct public as well as enormous private financial – and of course human costs. As if this were not enough, Russia’s war of aggression against Ukraine and the resulting international supply interruptions in energy, grain, and other goods increased public spending and reduced public revenues still further.
4. With no 99-year respite between these successive 100-year economic storms, a roller coaster of fiscal deficits has trended generally upward from the apparent late 20<sup>th</sup> century terra firma for OECD countries.
5. The resulting large fiscal deficits have padded sovereign debt burdens well beyond the capacity that national economies for decades had been prudently expected to carry (Figure 1).

**Figure 1. General government gross debt as a percentage of GDP, OECD countries, 2000 vs. 2022**



\* = 2000 or first available year, \*\* = 2022 or most recent

Note: data for Türkiye is for 2010 and 2022. Data for Chile, Mexico, and Iceland is for 2003 and 2022. Data for Korea is for 2008 and 2022. Data for New Zealand is for 2009 and 2022. Data for Israel is for 2001 and 2021. No data is available for Colombia and Costa Rica.

Source: [OECD National Accounts Statistics \(2024\)](#)

6. The last quarter century has reinforced the reality that economic history has by no means ended, and nations still face sudden and substantial shocks to their budgets and economies. Meanwhile, governments and the public already face still further contingencies that will put even more pressure on public budgets.

7. Prominent (but by no means alone) among these contingencies is climate change. The ultimate damage to public well-being is uncertain. In the present, extreme weather events have imposed public (and private, sometimes subsidized through grants or loans) costs of repair and restoration. Facing those costs has encouraged investments in mitigation, such as protecting shorelines against erosion.

8. Meanwhile, prevention through researching, discovering, installing and implementing new lower-carbon-emission technologies will require public as well as private investment in infrastructure, such as alternative fuelling systems and transportation equipment, as well as research and development on those technologies. Pricing carbon can help, but with distributional dislocation. Where private investment in green structures or equipment is perceived as highly risky, the public sector may face pressures to provide subsidies that make the private investment viable in the market for capital.

9. The ultimate need for green investment is difficult to measure, at least because the reaction of the environment to additional emissions is enormously complex and therefore subject to considerable uncertainty. However, given the heretofore unexpectedly rapid pace of climate change, many subject-matter experts will argue that the risk of investing too slowly substantially exceeds the risk of investing too quickly, and even in excess of the need.

10. As prominent as the contingent cost of necessary climate-change-targeted, “green” investment may be, other contingencies are of similar scale. The coronavirus pandemic refuses to go gently, leaving open the possibility of a variant that evades existing vaccines and increases costs yet again; and any number of different pathogens could follow. The war continues, and other geopolitical threats await in the wings. Cyber-attacks may come from any number of bad actors, with any number of motivations. Other risks, known and unknown, remain. In short, recent sad experience indicates that the work of government includes greater research and thought on the role of risks in our current budgetary predicament and its outlook, and the ongoing management of those risks.

11. This troubled recent history also raises questions about the meaning of sustainability itself. Although the world’s financial markets have absorbed the rise in debt from the shocks of the last two decades with surprising aplomb, and it has become fashionable among much of the public to believe that “deficits don’t matter,” there is ample reason for concern. Markets may have given grace to current high debt levels in part because they generally stem from exogenous conditions that affect all nations; but markets may become more critical if some particular nations fall behind in addressing their own debt overhangs, and concerns about a few nations could spread virally to others. Note that fiscal indicators are far beyond formerly recognized and widely accepted trouble indicators, that trends are alarmingly adverse, and that markets could react at any time – and once they do, it will already be too late.

12. Large sovereign credit demands on the part of the world’s major developed countries remain potentially destabilizing, both domestically and in the global financial markets. To the extent that those demands are met by trans-national borrowing, they could eventually and suddenly cause substantial drops in debtor-nation currency values, which could in turn increase domestic interest rates, depreciate currencies and raise prices of imports (and inflation generally), challenging macroeconomic stabilization policy. Over the longer term, large fiscal deficits can reduce domestically financed investment, and thus future incomes.

13. Large fiscal deficits on the part of the wealthiest nations are problematic also in that they draw capital out of the world's developing countries, where it is urgently needed to raise the lowest living standards.

14. In short, there is considerable uncertainty about the sustainability of current public budget outlooks around the world. And given the potential reactions of global financial markets, once the alarm bells begin to ring, it may already be too late to avoid substantial harm to living standards over much of the world.

15. These pressing issues have again drawn the attention of fiscal specialists to budget-process disciplines – or the lack thereof. Different OECD countries face different procedural or political issues to couple with their differing economic and fiscal problems. The Euro member nations have undertaken significant reforms to their fiscal framework, but it remains to be seen how those reforms will work in practice. The United States' budget rules, though at one point highly successful, have long been in abeyance. They were enacted in essentially their final form in 1990, and helped to bring about significant fiscal improvement, but then were repeatedly waived beginning in 2001 until they expired at the end of 2002. Conceptually limited replacements have been enacted in legislative rules, but have repeatedly been formally waived or cleverly manipulated. Despite occasional discussion and some abortive legislative attempts, the once-successful disciplines have not been renewed in any comprehensive way.

16. This paper discusses the open issues regarding budget process disciplines in the context of the current pattern of sustained fiscal deficits, rising public debt and economic risks. It begins by assessing the risks in the current outlook, acknowledging the enormous uncertainty they pose, and exploring how public policy should respond.

17. It proceeds to consider what sustainability requires in this uncertain outlook, and how the costs of preparing for risks must be balanced against the known needs for public services and investment to maintain living standards and support economic growth.

18. Finally, it assesses the apparent dormancy of current fiscal rules in some countries, driven prominently by the loss of public understanding and confidence at a time when discipline is needed most, and offers suggestions for rethinking the design of fiscal rules.

19. In sum, budget systems must account for risk, target meaningful measures of sustainability, and create and maintain accepted and effective budget rules. Achieving these objectives will be difficult in a world whose foundations have been shaken by recurrent rounds of heretofore unthinkable developments that have forced extraordinary responses that violate previously accepted norms. But clearly, restoring fiscal stability and consensus on pursuing sustainability is among the most important tasks of this day.

20. And with respect to the twin objectives of stability and consensus, the former is dependent upon the latter. The public does not understand complex budget rules, and has become cynical that elected policymakers routinely ignore them. Elected policy-makers recoil from asking members of the public to accept sacrifice for a system that they do not trust. This vicious cycle must be broken through communication of system reform, trust, and political will.

# 1. Fiscal Risks

21. Just before the beginning of the new millennium, some talked of an “end of history.”<sup>1</sup> This did not apply only to geopolitics. Although the apparent defeat of ideological communism was front of mind, there was also an equally apparent triumph of macroeconomic management and stabilization. Some expressed confidence in a “great moderation,” in which periods of growth were more extended and downturns were shallower and less disruptive than modern history had hitherto enjoyed.<sup>2</sup>

22. This confidence persisted even when many national economies proved to be overextended at the very turn of the millennium. OECD total quarterly GDP growth dropped below 1.0 percent in the second half of 2000, and did not regain that rate until the third quarter of 2003. Still, the resulting global slowdown proved to be comparatively mild and brief, and therefore by contrary example reinforced the sense of some that this remained the best of all macroeconomic worlds. But not only did that slowdown interrupt the extended economic expansion of the 1990s, it also broadly worsened budgetary results.<sup>3</sup>

23. Then, after a few years of general recovery (including perhaps a recovery of hubris) and a substantial increase of asset prices (especially in real estate), the global economy again proved to be overextended. In this instance, the correction proved to be much sharper and longer, as the overinvestment in housing required a longer period of economic recovery to achieve the necessary significant consolidation. OECD total quarterly GDP growth was negative, nil or minimal in all of 2008 and 2009; the OECD level of GDP (measured in U.S. dollars per capita) was lower in 2009 than it had been in 2007. And budgets were much more adversely affected; the OECD total ratio of debt to GDP jumped from 71.9 percent of in 2007 to 89.4 percent in 2009, and 104.4 percent in 2012.

24. And then again, after about a decade of what could fairly be called only moderate recovery, the string of shocks continued with the global pandemic, which struck the economy (not to mention the public health) fiercely in early 2020. Although the worst of the downturn was brief, it was exceedingly sharp. And although there was a quick bounce-back, it was only partial; caution in social and commercial interactions forced an economic slog for many months until the nature of the disease was more fully uncovered and countermeasures (including vaccines) could be aggressively deployed. So the hit on the global economy was of a different duration and depth profile than the preceding shock, but overall it was certainly more painful. OECD total GDP fell in 2020, and both the direct economic hit and the cost of the fiscal and public health countermeasures were certainly greater. The OECD total debt increased by 20 percentage points of GDP, from 106.8 percent in 2019 to 126.8 percent in 2020. And although the pandemic is substantially eased from its worst days of three and four years ago, it is not gone; and it could still mutate and reappear in a threatening form at any time.

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<sup>1</sup> Francis Fukuyama, *The End of History and the Last Man*, Free Press (reissue edition), March 1, 2006.

<sup>2</sup> For example, “The Great Moderation,” remarks by Federal Reserve Board Governor Ben S. Bernanke at the meetings of the Eastern Economic Association, Washington, DC, February 20, 2004. <https://www.federalreserve.gov/boarddocs/speeches/2004/20040220/>

<sup>3</sup> Of the 38 countries for which the OECD reported data, 26 had higher deficits (as percentages of their GDP) in 2002 than in 2001.

25. And still, the bad news is not over. The Russian invasion of Ukraine resulted in a painful interruption of global commerce (in addition to the even-more-painful human costs). Ukraine's production and exports, from food to technology products and services, was necessarily cut. And the world recoiled from trade with Russia, resulting in a substantial reduction of the global supply of oil and natural gas. The story of this economic shock, even more than that of the pandemic, is far from over.

26. Thus, over little more than two decades, the global economy has endured multiple major shocks. We are learning what can go wrong in this best of all possible worlds, even after the end of history.

27. Has the national budgetary environment become systematically riskier in this new millennium? That is a difficult question to answer. Each nation has been afflicted by each recent shock differently; and each nation has reacted to each of these shocks in somewhat different ways.

28. Notably in thinking of economic risks, the degree to which different nations have anticipated the shocks that they faced in their own economic and budgetary forecasts has differed. Some have even actively prepared for such shocks. Several nations, notably Finland, New Zealand, the Netherlands and the United Kingdom, have introduced overall fiscal stress tests.<sup>4</sup> New Zealand also has introduced stress test for financial institutions under climate change,<sup>5</sup> and for regulated institutions.<sup>6</sup>

29. The result is a multiplicity of episodes of economic shocks, and of individual nations' forecasts of and reactions to those shocks; and policy responses have arguably improved enormously compared with episodes of decades past. To the extent that bad news is anticipated and mitigated, the final impact on an economy can be lessened. Therefore, a meaningful picture of the degree to which economies across the globe have been buffeted by risks would entail a variegated picture of individual forecasting and macroeconomic stabilization systems, recognizing possible changes in these structures as the recent round of adverse developments has played out over time. It would be a distribution that would dwarf any central tendency.

30. However, looking in the broadest sense, there is ample reason for concern.

31. The last previous comparable pandemic occurred just about a century before this one. The last asset bubble similar in scale preceded the most recent one by almost 80 years. World War II ended also about 80 years prior. (By that scale, the business cycle of 2001 was quite of the garden variety; but the three subsequent episodes were all much larger.) One might infer from the confluence of those shocks a higher expected level of risk going forward – although, of course, those near-black-swan events need not necessarily repeat themselves.

32. Centuries of emissions of carbon (and decades of release of even more problematic gasses) have begun a process of global climate change. Although the task of understanding this process is a massive scientific undertaking, a broad predictable pattern of more-frequent extreme weather events is well underway. If anything, this process has been more rapid than generally predicted (although the range of prediction has been wide, and some estimates have been more extreme than others). Such extreme events have caused enormous damage which has required reconstruction of physical capital. They have motivated substantial investments in protective mitigation. And they have called forth further investment in technology to reduce and prevent future emissions. This entire class of budgetary threats was viewed as a fringe concern as little as 30 years ago; now, it is considered by some as potentially existential. Developing, installing and implementing new lower-carbon-emission technologies will require public as

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<sup>4</sup> Organisation for Economic Cooperation and Development, "OECD Best Practices for Managing Fiscal Risks: Lessons from case studies of selected OECD countries and next steps post COVID-19," pp. 10ff. 15 June 2020. [GOV/PGC/SBO(2020)6].

<sup>5</sup> Reserve Bank of New Zealand, "Climate Stress Tests assess resilience of major NZ banks." <https://www.rbnz.govt.nz/hub/news/2024/04/climate-stress-test-assesses-resilience-of-major-nz-banks>.

<sup>6</sup> Reserve Bank of New Zealand, "Stress testing regulated entities." <https://www.rbnz.govt.nz/financial-stability/stress-testing-regulated-entities>.

well as private investment in infrastructure (and, potentially, public subsidy for risky private investment). In the most reasonable expectation, the benefit of such investment is cost avoidance, not increases in output that could retrospectively finance that investment (although we can hope for incidental synergies or discoveries that could increase productivity). The ultimate need for such green investment is difficult to measure,<sup>7</sup> although given the heretofore unexpectedly rapid pace of climate change, subject-matter experts will argue that the risk of investing too slowly or too little substantially exceeds the risk of investing too quickly or in excess of the need.

33. These apparent worsening of the outlook for risk only adds to what was already a consequential preexisting baseline of natural disasters. And on more customary ground for budget worriers, the business cycle clearly has not been repealed.

34. Still, there is some reason to believe that there are contrary trends that might mitigate the popularly perceived increases in risks.

35. For example, economic stabilization policy appears to become more effective as knowledge and experience build. For example, macroeconomic policy responses to the 2008 financial crisis and the pandemic were clearly better judged and more successful than in the similar episodes decades ago. The loss of aggregate output was probably less than it would have been under the prior public-policy responses, although the public budgetary costs were still substantial.

36. The research and development process in response to climate change has yielded impressive progress, including some innovations that may reduce widely anticipated increases in costs, and may even possibly increase productivity and incomes in the long term. For example, developments in both the quality and cost of vehicle electrification have exceeded many expectations.

37. Furthermore, economic shocks can be positive as well as negative. One currently prominent opportunity is the advancement of artificial intelligence, which, if effectively blended into business organization, could increase productivity in a wide range of enterprises. Another is “individualized medicine” based on advances in genetics (although expensive remedies for currently incurable diseases, which would be welcome but may add to costs, could rank higher in the research queue than lower-cost replacements for existing therapies).

38. As the last quarter century has demonstrated, the range of economic and budgetary uncertainty is enormous; and although there is evidence of unexpected innovation in productivity levels, the most conspicuous budgetary surprises have been negative. Without presuming that further adverse risks will necessarily be realized, and especially in light of current elevated levels of public debt across many countries, prudence strongly indicates that budget processes incorporate risk on a systematic and effective basis. Indeed, preparing for risk has become a core task of budgeting.

39. So how should fiscal authorities budget in the face of current concerning debt levels, with the recent history of costly budgetary shocks, and at least the prospect of extended and recurring episodes into the future? In short, how should risks be incorporated into the budgeting process on a systematic basis?

40. **Baselines vs. Risks:** The first and perhaps most fundamental step in the process is to define, and thereby restrict, the universe of contingencies that should be considered as “risks” for purposes of the budgeting process. One currently used definition is that risks are sources of large potential deviations from the fiscal forecast.

41. A corollary of that definition is that known fiscal pressures – like population ageing – should be included in the fiscal forecast, and should not be considered as risks per se. The inclusion of a particular

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<sup>7</sup> International Monetary Fund (IMF). 2021. *Fiscal Monitor: Strengthening the Credibility of Public Finances*. Washington, October, p. xii.

program in the baseline – the fact that it is known and expected – is an important distinction for this purpose. But there are further essential nuances in this definition that arise from the consideration of particular examples.

42. Recent efforts across countries have revealed some regularized patterns. Some contingencies are evident, relative certain, and predictable in terms of cost with considerable accuracy. One such example is the coming fiscal stress from population ageing. Accordingly, the costs of addressing population ageing are typically entered in the fiscal baseline, and are not considered to be risks per se. However, the degree of predictability of costs is a continuum, and the future costs of some evident and actual budgetary contingencies, such as climate change, are much more uncertain. Any particular natural disaster is highly uncertain, but year by year the occurrence of disasters is relative regular, although the costs are variable. Similarly, rising health care costs will unquestionably weigh on public budgets, but the rate of growth of those costs is uncertain, and will have enormous leverage on fiscal outcomes. Accordingly, the effects of climate change and health care costs are typically included in fiscal baselines; and as a result, some might determine that they are no longer “risks” at all, at least strictly defined.

43. And there is a logic to that determination. However, even programs that are included in the baseline may still be “sources of large potential deviations in the budget outcomes,” if the magnitude (and possibly also to some extent the probability) of the cost is highly uncertain. Thus, many of the costs that arose even from the pandemic, such as the delivery of health care and the protection of the public health, fell under the headings of known and budgeted government programs – but their costs expanded well above their projected limits, even though those programs were part of the “baseline.” Therefore, such contingencies will demand attention alongside budgetary risks more-strictly defined.

44. Some fiscal risks are identifiable, but their costs are only potential. For example, contingent claims against explicit and acknowledged public guarantees, such as for failures of financial institutions, may or may not arise at all in any given budget year, while their magnitudes are also unpredictable.

45. And finally, there are fiscal risks whose very existence is unknown. Looking backward, for example, the onset of something like the COVID-19 pandemic, though in some circles a subject of serious biomedical research, was for most of the public unimaginable. The invasion of Ukraine also might have qualified for this grouping – although we would expect our security intelligence process to reveal hostile preparations for such actions ahead of the event. Obviously, there is no countable set of such contingencies, and their magnitude is bounded only by the imagination. But at some level, budgets must make room for the unknown; some might say that one essential objective of fiscal stability is the preparation for the unknown.

46. The next step, after fiscal risks are defined, is to identify and catalogue individual risks to the budget.

47. Given the painstaking work required to execute on known and intentional programs focused on evident needs, preparing for uncertain contingencies may easily be forgotten and ignored. Accordingly, not only governments but also line agencies and nongovernmental research institutions should be charged as a matter of routine practice with the task to identify and catalogue risks as part of the comprehensive routine budget-policy-making process, to ensure that contingency planning does not wait until after the actual occurrence of the contingency.

48. **Analyse risks:** Good practice for analysis of risks can include distribution of responsibility among the subject-matter agencies that have the greatest expertise; meanwhile, macroeconomic risk might be the responsibility of finance ministries. However, once responsibility for analysis of risks is divided so broadly across government, a systematic process will require diligent coordination. The lead might be given to a finance or a budget ministry, which may have such authority in the budget-policy-making process to demand engagement by a wide range of program agencies, some of which might be predisposed to ignore remote contingencies and instead allocate their own scarce time and energy to their day-to-day operations.

49. Such a risk-analysis process also will require senior-level commitment, including frequent communication and meetings. Maintaining attention to such planning for contingencies in a busy day-to-day policy world might be facilitated by requiring review of official reports by outside research institutions or by the legislature. If such critical review can be expected, senior agency officials will be more motivated to ensure that the risk-analysis process is undertaken carefully.

50. Experience indicates that functional divisions of labor might be appropriate. Some agencies might provide historical data while others would provide future projections, for example.

51. In an ongoing risk-analysis process, new risks created by legislation or caused by circumstance and identified by research should be highlighted, including in the legislative process, in which such risks might be taken on by the content of new legislation. Program design or legislative specifications might be different if policymakers are conscious of the implications of their decisions for fiscal risks.

52. **Manage risks:** Again, through an organized, consistent process, ideally mandated in primary law, government should develop its analysis of its identified portfolio of individual risks into management of overall fiscal risk.

53. Management includes prevention of potential risks, as well as mitigation of realized risk. The costs for prevention might be immediate, but the costs for mitigation might be required only in future years, requiring reserves or rainy-day funds. The costs might be purely contingent and potential; or alternatively, it might prove cost-effective to prevent or mitigate the risk through up-front temporary or permanent investments in prevention and remediation. Costs identified by this process might be temporary or permanent; they might be predictable with some measure of precision, or highly uncertain. Paying those costs might provide monetary benefits to society through uncovering new knowledge that will increase future productivity (as some might allege is likely in the effort to reduce carbon emissions through vehicle electrification), or they might only avoid societal costs.

54. The prevention and mitigation process, like the underlying analysis, may be difficult to motivate while budgeting and managing resources for clearly apparent, day-to-day priorities is front of mind. Different managerial methods may help to give risk management the emphasis it is due given the potential costs of disasters and shocks. Fiscal risks statements or reports, arguably, help to maintain attention in busy times when potential risks are not top of mind. Requirements for standards of management imposed in primary law might focus attention. Directing those requirements toward specific agencies and their leadership could impose a recognizable cost if the responsible officials fail to deliver. Independent fiscal institutions (IFIs) can have a key role.

55. One difficulty in management and analysis of risk is the potential importance of national security in the range of future risks. As much as transparency and specificity might aid in both the quality and the public acceptance of risk analysis and management, depictions of potential security risks may not serve the national interest. Special handling of security risks, with generic discussions of potential costs and government responses, will be necessary.

56. Stress tests may be an important tool, though they can be difficult to employ productively. In theory, a stress test can provide cost estimates for varying degrees of severity of a particular contingency, and thinking through the estimating process might raise awareness of interactions among programs or risks that could otherwise escape analysis. And it is possible that stress-test modeling for one class of risks might provide synergies for other classes, and therefore facilitate a wide range of effective analyses.

57. However, given the enormous range of scale for many types of risks, truly useful scenarios for stress tests may be difficult to design. Interactions among elements of the economy and of the budget are difficult to quantify. It would be easy to dial up the magnitude or frequency of realizations of risks so far that the ultimate outcome was merely a horror movie. Perhaps even worse would be an exaggeration of the likely costs of risks, leading to an excessive diversion of resources to risk mitigation and remediation from everyday public investment or government operation. Still, without quantification, the exercise

becomes meaningless. Best practices must be developed and disseminated so that the positive features of stress tests are exploited without misleading distraction. Historical scale can be one guide, but analysis of trends and of developments in the forces underlying risks must be included.

58. In short, the definition and the analysis of fiscal risks are based on continua of characteristics. Risks involve unknowns. Apart from the totally unforeseen (like, perhaps, COVID-19), fiscal risks may be uncertain in their occurrence or in their cost. Important fiscal forces like population ageing are well anticipated and accurately predictable, and so may be consigned to the fiscal baseline and not considered as risks strictly defined. But there remain a wide range of contingencies – too wide for comfort – that require special consideration in the budgeting process, and call out for safety margins to ensure that our fiscal finances are truly sustainable.

## 2. Fiscal Sustainability

59. Sustainability, almost universally recognized as an essential objective of budgeting, can be defined broadly as a nation's favorable and consistent access to credit markets. If a country's sovereign credit is widely trusted to be justified by the scale of its economic output, its ability to collect revenues, its fiscal behavior, and its price stability, then credit markets can provide financing with confidence – and at low interest rates. Market assessments based on uncertainty and fear will surely lead to higher risk premiums and debt-service costs, to the detriment of the nation and its population, and of international commerce.

60. The prerequisites of sustainability in this sense will differ across countries. In the broadest terms, small countries might be more vulnerable than larger countries; open economies might be more vulnerable than others that are more self-sufficient (and in particular, Japan's virtually complete domestic financing of its own public debt has protected it from the worst consequences of a very large debt). More-developed countries might be more favorably regarded by the credit markets than their less-developed counterparts. Countries that have histories of credit crises are more vulnerable than others with more blemish-free records. Countries that are perceived to suffer large fiscal deficits as the result of their own policy excesses are likely more at risk than others that have suffered more as a result of exogenous global conditions (the pandemic, e.g.). As the supplier of the world's reserve currency, the United States is in a unique position; at the end of the last century, some professed fear that the United States' paying down of its debt would excessively reduce the supply of riskless benchmark financial securities, and argued that the United States should limit its budget surpluses for that reason. Others, of course, dissented vigorously.

61. Countries differ according to their initial (i.e., current) budgetary conditions. In the opinion of some, many nations are already in danger of losing sustainability, and thus are already in need of fiscal consolidation to safeguard it. Nations also differ according to the budgetary risks that they face in their futures. The growing realization of the magnitude of widespread budgetary risk has only strengthened the perception of a need for fiscal consolidation.

62. In the past, many observers considered sustainability to be a condition that was attained once and for all, like an individual's target weight is to many who see the desired number on the scale and terminate the exercise and diet program with a celebratory dinner.

63. From a more-technical perspective, economists sometimes define sustainability as merely maintaining a stable maximum ratio of public debt to GDP and avoiding an indefinite rising path which cannot be sustained over the long run and could become explosive.

64. However, this approach yields a knife-edge target. If the budget is written to maintain the current ratio of debt to GDP, and the budget deficit turns out to be smaller than anticipated, then the ratio of debt to GDP falls; but on the other hand, if the budget deficit is larger than expected, then the debt to GDP ratio rises. On the one side, the power of compound interest can quickly become a fearsome foe; on the other, it is a welcome and trusty ally.

65. Recent history suggests that reference to knife-edge conditions of putative sustainability tends to be made when debt levels are high and budgets are marginal. The conclusion to which the audience is led is that budgetary conditions are not so bad; budgetary space remains available; and fiscal consolidation can be put off to another day. Arguably, this line of reasoning has had unfortunate consequences, which have become increasingly apparent as debt levels have continued to rise.

66. Fundamental in the current context is the reality of risk. If the budget is walking a knife edge, it can be set falling in the wrong direction at the very onset of an unfavorable breeze. The stronger the wind, the steeper the fall. And the longer the fall, the more difficult the climb back to grace. For whatever reason –

because of a bout of bad news, or the onset of spending or tax-cut ambitions, or whatever else – what had been debt ceilings seem to have become debt targets. And especially if sustainability is taken to be a mathematical condition of stasis in the ratio of debt to GDP – which is that knife-edge condition – the very existence of the budgetary risks just discussed would render such a condition inadequate.

67. And at this moment, national balance sheets and budgets around the world face daunting initial conditions. In other words, maintaining knife-edge sustainability today means remaining in adverse and risky circumstances. And when national budgets were stronger about a quarter-century ago, one of the frequent arguments for maintaining discipline was to build a margin of safety for future contingencies – a margin which, if it ever existed, has now been more than fully deployed. Simple mathematical balance-sheet sustainability is surely not an appropriate goal at this time.

68. Furthermore, it is arguable that an operational mathematical concept of sustainability is inherently permissive. If walking on the knife's edge is an acceptable outcome, and some unexpected budgetary good news should arise, then surely spending the proceeds of that good news is acceptable as well. But if every budgetary day is a random process with a variance around a mean outcome of net zero, then spending all the good news is a plan for a continuing net negative outcome. Such a principle sets a course for asymptotically approaching ultimate disaster.

69. To be fair to the concept of mathematical sustainability, a budgeting process can be based on a target of sustainability with a firm allowance for a margin of safety. That would be acceptable (and more likely sustainable) if the safety margin could assuredly not be reallocated as a slush fund if outcomes were favorable in any particular year or two. The value of additional public investment today must be weighed against the value of additional fiscal space, through reduced debt-service obligations, for public investment tomorrow (with a permanently lower debt burden). The safety margin can be truly safe if it is created by using a genuinely cautious economic forecast to derive the fiscal baseline. However, the resolve to forecast the economy cautiously can be short lived if that cautious forecast is interpreted by the public (perhaps at the suggestion of the political opposition) as pessimism on the part of the government as to the efficacy of its own economic policy.

70. Furthermore, for all of the effort that brought the welcome success of raising our sights to a medium-term budget horizon, we must admit that the world does not end there. Now, with debt burdens so far above historical norms, our vision must necessarily extend further. But even beyond the current painful debt extremes, we should have a deeper awareness of how far we have fallen, and what made us fall so far. Budgetary concern must extend to the next realized risk, because sooner or later, that crisis will occur. And concern today must embrace the fiscal security of future generations, because if it does not, future generations will not embrace us. As debt burdens are gradually worn away in the coming years, we must do better with that next opportunity to attain, and safeguard, sustainability.

71. In sum, current circumstances can be seen to demand a change of mindset on the part of budget officers, rather than reliance on particular shorthand definitions of sustainability, or approaches to budgeting for sustainability that may or may not suffice for practical budget work. This mindset should be cognizant of the increasing upward pressures on spending baselines from the interaction of population ageing and rising health care costs, which cannot be totally negated by even the most creative use of incentives and efficiencies, plus all of the other risks discussed earlier.

72. Instead, taking the lesson from the collapse of budgetary discipline and the buildup of debt in the early years of this century, nations should nurture a mindset that, for achieving fiscal resilience and fiscal intergenerational equity, the steady-state condition of public budgets should be a target of a declining ratio of debt to GDP, rather than the attainment of a given minimum limit of debt to GDP ratio. If debt to GDP ratios are considered targets when they would be better understood to be ceilings, and if mere stability is taken as the primary objective, it is only a matter of time before some risk eliminates the existing fiscal space and sends the debt to GDP ratio back up again. Nations should build truly ample reserves against the newly appreciated budget risks that they identify in the processes described earlier. So for the long

term, budget leaders need a change of attitude. But for the short and medium term, they need perhaps greater, albeit realistic, resolve – and sound fiscal rules, once again.

73. In sum, budget sustainability, which was once perhaps thought of as a state of eternal bliss, now looks more like a state of eternal struggle. Relatively well understood pressures of population ageing and rising health care costs now must share the stage with an array of risks from climate change to migration to new threats of national security – and beyond, into the unknown. Debt-burden ceilings which were not long ago assumed to be padded now are shattered glass. This environment requires serious analysis of fiscal risks, but also and in part as a result of those risks, also a new respect for the demands of sustainability in an uncertain world. To achieve needed greater margins of safety, budget policymakers must improve their rules, not only in terms of technical efficacy, but also in understanding and buy-in from the public, and resultant strengthened political will.

### 3. Rethinking Fiscal Rules

74. So, how can budget rules help to bring debt burden levels back down to safe territory, while also warding off – or preparing for, at least – any relapses of the fiscal risks that have plagued the last two decades? And all that at the same time our countries are facing large and compelling spending pressures, some even “existential” in nature (while others, like population ageing and health care, are merely relentless)?

75. The pressing concerns about economic and budgetary risks and eroding financial sustainability have again drawn the attention of fiscal specialists to refining and improving current budget-process disciplines – or the lack of viable disciplines in the first place. Fiscal rules today must move currently excessive debt and deficits into a sustainable condition, while protecting the budget outlook from risks. Merely recovering from the recent fiscal deterioration is a task daunting enough; preparing for future spending pressures and risks is a full leap beyond. We will discuss these tasks separately. Emphasis on the role of risks is of course an important part of this particular discussion.

76. Formulating spending rules to achieve those objectives will present policymakers and the public with a clearer vision of what will be needed in the medium and long term. The best fiscal rules that experts can design would at least give policymakers and their constituents a standard by which to judge actual behavior, and to hold policymakers to account.

77. No fiscal rule should be expected to do the impossible. Specifically, no fiscal rule will achieve its desired budgetary results if and when the political will of policymakers is to the contrary. A legislature’s procedural rules can be changed or waived, and restrictive laws can be amended or repealed.

78. However, one thing that a fiscal rule can do is to expose steps contrary to stated fiscal guidelines. If policymakers must vote to waive or change the procedural rules, and to amend or repeal the statutory fiscal disciplines, these additional procedural steps usually involve at least an implicit admission that the policies that follow do violate the budget restrictions that had hitherto been accepted as wisdom. Such restrictions clearly are not insuperable. However, they might provide some measure of deterrence against violations of fiscal responsibility, because they are plainly visible, and because they can be cited later by political opponents if events go awry. Budget deficits are inarguable only after the fact, and policymakers can dissemble with optimistic assumptions or estimates, long after their policy actions are taken, that the deficits (or worsened deficits) will never actually arrive. But policy steps that might violate appropriations caps or pay-as-you-go restrictions are apparent as soon as they are taken, and the numerical results are less subject to dispute. This is one reason why tax-and-spending rules have gained favor.

79. **Current scepticism.** In the wake of the budget deterioration thus far in this century, opinions of fiscal rules tend to be quite adverse. Some policy makers, and many typical citizens, find budget rules to be hopelessly complex, and despair of ever understanding them. Perhaps even more citizens believe that policy makers do not follow fiscal rules in any event, feeding a growing lack of trust; while some critics believe that fiscal rules have been too constraining in periods of economic shocks and slow growth. All of the adverse developments of the last 20 years combine to feed that distrust with continuing torrents of budgetary bad news.

80. However, if budget rules in recent years have not motivated policymakers and achieved the vocal support of the citizens, it is far from clear that giving up on fiscal rules would do so. And all of those adverse developments, and all of that accumulated debt, leave many nations in need of better budgeting. And for all of the scepticism, there is evidence that sound fiscal rules can yield substantial budgetary benefits, and economic rewards more broadly.

81. And another thing that fiscal rules can do is communicate to the public, build confidence and trust, and thereby strengthen political will. An informed public will demand change from elected policymakers. Elected policymakers will seek to satisfy an informed public. Sound fiscal rules will motivate both the public and their policymakers, and show how improvement can be achieved. Better rules are perhaps the best way to reverse the current vicious cycle of distrust and failure into a virtuous circle of trust and progress.

82. Among the most fundamental of the conundrums that face all of those researchers in this field are whether fiscal rules help nations to achieve better budget outcomes, or rather that nations that are predisposed to seek better budget outcomes impose fiscal rules; and whether fiscal rules can substitute for, or rather are fully reliant upon, strong institutions of governance otherwise. Scholars and policymakers can debate such vexing questions endlessly. However, if a nation is at budgetary risk, it must begin somewhere to build a road back to sustainability. Creating a sound system of budget rules may be the best way to establish, and pursue, its good intentions with the financial markets, and with its public – even if it may take some years to build that essential fiscal foundation. Success in budgeting can then spread to other public institutions, built upon improved public trust.

83. Potentially, for nations whose budgetary situations are problematic, an early step toward fiscal responsibility can pay important dividends. Beginning to build the first foundations of trust with the financial markets can reduce risk premiums on sovereign debt securities, and thereby increase the maneuvering room for a transition to a more-sustainable budgetary stance. The International Monetary Fund puts it that “committing to fiscal sustainability with credible frameworks—the set of rules and institutions that guide fiscal policy—can buy time and make debt stabilization or reduction less painful.”<sup>8</sup>

84. **Credibility requires realism.** Over-ambitious promises of rapid fiscal consolidation that fail can damage credibility, whereas measured commitments that are kept can build trust. There is a history of imposing “unthinkable” penalty alternatives if ambitious deficit reduction goals are not met; but truly unthinkable penalties will never be allowed to happen, and will merely be postponed and eventually repealed entirely. Thus, early steps toward establishing budget processes and fiscal responsibility programs must necessarily be cautious; but they cannot be too much so.

85. **Need for a longer-term perspective.** One important dimension in which all budget processes today must be somewhat bold and ambitious is that of time. The road back to pre-pandemic measures of sustainability stretches far into the future.

86. Not too long ago, fiscal policymakers were pushed to achieve a major leap of consciousness from a fixation on a single year’s budget to medium-term policymaking. Much progress was made. And medium-term forecasts and rules two or three decades ago, in a broadly sustained period of prosperity before multiple risks reared their ugly heads, were almost long-term devices – because they extended fully into a future time when many nations’ public budgets could already have achieved a substantial measure of sustainability, and economies could have been expected to have achieved at least near-full utilization – a projected fiscal “soft landing” into an assumed future of steady-state bliss.

87. Now, after multiple shocks and with debt burdens well in excess of past targets, medium-term forecasts fall well short of the time of reaching those goals. The International Monetary Fund roughly assesses that it will take more than a decade of primary deficit levels lower than were commonly maintained pre-pandemic to recover the same pre-COVID debt levels.<sup>9</sup> Realism requires recognizing that difficulty. Recovering from past shocks of the magnitudes the world endured – not to mention managing budgets should similar shocks recur in the future – requires at least seriously contemplating decisions that extend well beyond the commonly understood medium term. As welcome as has been the strengthening

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<sup>8</sup> International Monetary Fund (IMF). 2021. *Fiscal Monitor: Strengthening the Credibility of Public Finances*. Washington, October, p. xii.

<sup>9</sup> *Ibid.*, p. xii.

of medium-term budgeting as a vital institutional reform, the long term is the new medium term; and policymakers aided by well-designed fiscal rules need to communicate that perspective to the public and the financial markets.

88. **Inevitable tradeoffs: complexity versus specificity.** Budget rules are asked to meet multiple demands. Those demands are often in conflict, and the task of building the rules to reconcile those conflicting demands is daunting.

89. Some find budget rules to be too complex, and the resulting lack of understanding only erodes trust still further. However, a simple rule would not necessarily achieve all of its objectives across the diversity of conditions over time and in different nations. At the end of the day, each nation's budget rule must be built upon that nation's own institutions and its political consensus and attitudes. And so, successful budget rules across nations will be different, and will be more or less simple in each setting.

90. For perspective, and thinking purely abstractly, what would make a budget rule "simple," or at least understandable, in the eyes of the public?

91. In the broadest sense, a simple budget rule would be built upon concepts that the public readily understands. And it should have targets that do not change substantially from year to year, and are at least logically consistent over time.

92. A deficit rule like the debt brake that is employed in several nations, which calls for continual (even if usually small) adjustment of the fiscal targets and of budget policy, might raise greater concern in the financial and investment markets. This would be especially true if policymakers were eager to loosen fiscal policy when circumstances allowed, but were reluctant to tighten policy when situations required. From this perspective, a deficit rule would create more occasions for loss of credibility than would a tax-and-spending rule, which would allow automatic stabilizers freedom of action, but would usually limit tax and spending policy changes to deficit-neutral steps.

93. Along these lines, a successful (so long as it was maintained) budget process was the United States' spending-and-revenue rule based on annual appropriations caps, set over a medium-term horizon (five years), and multi-year "pay-as-you-go" (or PAYGO) restrictions on entitlement programs and revenues. The appropriations caps were simple enough; the somewhat less transparent PAYGO rule requires that any reductions in taxes or increases in entitlement spending must be fully offset by other increases in taxes or reductions in entitlement spending. This budget rule was more complex than some deficit rules. Arguably, the complexity was necessary because the U.S. budget was far from balance, and so a simple deficit rule would have been infeasible. Indeed, a kind of deficit rule was tried over the preceding five years, and it failed miserably – not least because that much simpler rule (known as Gramm-Rudman-Hollings, or GRH) was manipulated to death by the U.S. legislative process. In contrast, from its creation in 1990 until its expiration in 2002, the U.S. spending-and-tax rule saw a remarkable progression from record budget deficits to record budget surpluses – which immediately dissipated without observance of the rule.

94. Among the complexities of the U.S. system, the PAYGO restriction was imposed on changes in policy, not on increases or decreases in revenues or cyclically sensitive benefit programs that were caused by economic ups and downs. Accordingly, it was more compatible with countercyclical automatic stabilizers than is a deficit-based budget rule that implicitly encourages spending reduction or revenue increases in economic downturns (to make the target budget deficit look smaller), or alternatively can be taken as permissive of gratifying but pro-cyclical spending increases or tax cuts when the economy is strong. Some might argue that the U.S. spending rule was allowed to expire because it was too complex to encourage public understanding and buy-in; others might contend that was left to die on the vine despite its inarguable success of achieving budget surplus merely because the temptations to enact self-indulgent spending increases and tax cuts were simply too strong for elected politicians to resist.

95. Budgeting must not be reduced to mere “public relations” or “messaging.” However, essential technicalities aside, a tax-and-spending rule can be explained to the public very simply: Policymakers may not act to increase the deficit; any new initiative, whether a tax cut or a spending increase, must be “paid for.” The typical citizen need not master the details of the estimating process behind the enforcement of that simple dictum to understand, and to accept, what a tax-and-spending rule is designed to do.

96. However, for many nations today, mere deficit neutrality in future policy decisions will not suffice; budgets are already on a path of spiraling debt service and debt. There are two potential remedies, which can be combined. One is to combine the enactment of new or revised budget rules with changes in policy sufficient to reverse that vicious cycle. The other is to require enactment of future budget savings in the new rules. One part of any tax-and-spending rule is a cap on future appropriations of discretionary spending, at levels consistent with a medium-term downward path of the debt-to-GDP ratio. But a second part, if needed, could be a requirement of future savings through entitlement spending cuts and tax increases (or in the language used in the United States, a debit on the PAYGO scorecard for future years). In other words, future initiatives in this category must be “more than paid for.” This must not be an empty promise; it could be credible if the commitment to future savings could be combined at the same time with the enactment of meaningful current savings, along with the establishment of new, well-designed rules. For nations with existing budget problems too large for an immediate solution, some future commitments, combined with current policy reforms and improved rules to provide credibility, might be the best feasible solution.

97. Each nation’s circumstance is unique, and each nation accordingly must create its own fiscal rule. However, to some extent, nations that must struggle to create a successful system surely can find models of elements of success around the world. And perhaps nations that must build credibility from the ground up can “buy,” “rent” or “borrow” some credibility by making reference to successful systems whose rule components they use. There can be substantive synergies between countries, and there surely also can be a calming effect in global markets from any proliferation of similar efforts to build budget discipline.

98. **Realistic budgeting.** Another imperative in forecasting and planning future budget rules is that assumed baseline spending levels – that is, those apart from preparations for and responses to risks (notably personnel and operating costs, which are key to the core functions of governments) – must be adequate and realistic. There has also been concern that fiscal rules might prevent the provision of adequate funding for public investment (such as human-capital building, infrastructure, research, and so on). An assumed impossible future spending ceiling that shortchanges such core elements of government, and will inevitably be waived, is in reality no ceiling at all; rather, it is a self-deception that allows infeasible commitments in other budget categories. It postpones difficult decisions, whose costs therefore compound with interest so long as the self-deception continues. In contrast, ambitious but realistic targets for future spending restraint can motivate managers to improve efficiency – not merely to keep their heads down until the budget-slashing storm is over.

99. **Harmony with counter-cyclical monetary policy.** Fiscal policy rules should be judged as well on their harmony with sound monetary policy making. Predictability and stability are essential. Monetary authorities would be more confident in taking important decisions, either to act or not to act, if they could rely on the fiscal process to follow a sound and steady course. On the other hand, a fiscal rule that could lead to abrupt and unpredictable changes would make monetary policymaking much harder, and make monetary authorities in effect compete with fiscal policymakers, rather than cooperate with them.<sup>10</sup>

100. **Independent fiscal institutions.** There is a potential role for independent fiscal institutions (IFIs) to reinforce the credibility of the budget rules to make them successful. IFIs can verify the reasonableness

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<sup>10</sup> Alan Blinder, “Issues in the Coordination of Monetary and Fiscal Policy,” in *Proceedings of a Conference on Monetary Policy Issues in the 1980s* (Federal Reserve Bank of Kansas City, August 9-10, 1982), pp. 3-34, highlights this concern; Matthew B. Canzoneri, Robert E. Cumby, and Behzad T. Diba, “Should the European Central Bank and the Federal Reserve Be Concerned about Fiscal Policy?” tend to disagree.

of budget baselines and economic projections, endorse good-faith compliance with fiscal rules in difficult times, and thereby build trust with the public. To fulfill that role, IFIs must take ownership of that responsibility; have guaranteed operational independence; have adequate staffing; and maintain nonpartisan and transparent assessment of fiscal policy that is communicated clearly to the public.<sup>11</sup>

## Green Spending and Fiscal Rules

101. The budgetary bad news of the last 20 years, beyond bearing a greater load of debt, also sends a danger signal of potential further risk in the future. We can hope that a string of bad luck has ended; but relying on that good fortune would not be prudent. Unfortunately, planning for risk certainly adds some unwanted complexity into fiscal rules.

102. Even after a functional budget rule to recover from today's higher debt burdens can be settled, the ghosts of the 21<sup>st</sup> century economic shocks will linger in the background. For example, increasing urgency surrounding climate change will confront policymakers with the need for flexibility in the fiscal rules not only to overcome the reluctance to undertake painful fiscal consolidation, but also to meet the needs for additional green investment. Climate change, of course, is only the most prominent of all of the risks that must be addressed in budget execution over the coming years; unexpected growth in health care costs, compounding population ageing, could have much more leverage on fiscal outcomes. But effectively incorporating risks and contingencies into a budget rule is yet another challenge to the goal of simplicity and understandability for the public and for policymakers.

103. And on this most prominent of risks, the need for fiscal stability and the need for climate stability must be reconciled. Specialists in these two fields seem to find themselves painfully and continuously at odds; each side seems to believe that the other underestimates the seriousness of its own top-of-mind issue. However, the community of nations is by no means limited to one existential crisis at any given time, as certain as it seemed 25 years ago that we were favored with having none at all. Now, like the oncologist and the cardiologist who find themselves hovering over the critical-condition patient who suffers from both cancer and heart disease, the environmentalist and the budgeteer plainly must learn to get along. Arguing over the body of the deceased about which malady proved to be the ultimate cause of death does not bring him or her back, and serves no productive purpose. One disease cannot be ignored because of the assumed primacy of the other. (Still more unfortunately, other risks, like the war or the pandemic – and other better-known baseline issues like health care – could easily join climate change as critical, and must be considered actively as well.)

104. The budgetary task of managing green investment includes not only determining the appropriate amount of investment and ensuring that the resources allocated are neither too high nor too low, but also ensuring that only true investment is included. There is a long and bitter history of exploiting privileged categories of spending by including outlays that do not truly qualify.

105. Although the priority that fiscal responsibility and green investment are given in time – which is addressed first, and how much the other is delayed – is important in its own right, of note is that fiscal restraint that reduces the accumulation of debt (and that may also cause reductions in interest rates on sovereign securities) can also open more budgetary room for green investment (and other priorities) in the longer term. A strong case can be made that amelioration of climate change is urgent. However, if deeper planning (such as allowing more time for choices among alternative technologies) would be helpful, using that time also to build an earlier, stronger foundation of debt abatement would pay a subsidiary dividend in greater budgetary space in the years to come.

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<sup>11</sup> Kopits, G. (2011), "Independent fiscal institutions: Developing good practices", OECD Journal on Budgeting, Vol. 11(3), pp. 1–18, especially pp. 15-16.

106. So it will be necessary, once the budgetary risk of climate change is adequately assessed and the need for remedial investment is determined, to ensure that appropriate allowances are recognized in the budget. That may include amounts of investment spending in a current year or in future years, with the amounts scaled appropriately over time. Meanwhile, the budget will also need to mandate sufficient restraint elsewhere, in other spending or revenues (or both), to achieve medium- or long-term reduction in ratios of the public debt to GDP. Thus, there will be pushes and pulls on the budget over multiple years. To maintain the confidence of the financial markets and keep risk premia down, budget authorities will need to demonstrate that they are meeting their targets in each of these categories of the budget – that green investment is within its designated limits, and that savings in other parts of the budget are being achieved. In this respect, also, long-term planning will be essential. Policymakers will need to match their ambitions with their resources over an extended period of time, and make necessary mid-course corrections to keep the (carbon-emission-free) budget train on track.

107. Under a budget rule covering a multi-year plan, an anticipated amount of green investment could be included over one or several years, and be assumed to phase down as the investment program is completed. The cost of the investment program could be recovered during and after its lifetime with spending cuts and tax increases (which could themselves be phased down in later years). This would be similar to the ad hoc responses underway for the additional spending (and reduced revenues) from the pandemic (which are incorporated formally into the Swiss debt brake, as one potential model).

108. Among the beneficial complexities of the U.S. revenue and spending rule, an alternative model system of fiscal rules, was the possibility for the budget goals to be broken into categories of spending and revenues. It therefore could state explicitly an allowance for green investment with caps on other spending, and the budget rule itself could be directly monitored for separate compliance with green investment increases and reductions in other spending (or increases in revenues).

109. In sum, thinking on budget rules has evolved, and for good reason. Deteriorating budget results have eroded public trust, which in turn has depleted the political will to propose necessary fiscal restraint.

110. To achieve success, different nations surely will breed different budget systems, with unique roots in their own institutions of governance. And in the old country adage, “If it ain’t broke, don’t fix it.” However, many national budget systems do need fixing, and the evolution of broad common patterns of thought opens the opportunity for generally similar rules that can use the experience and success of other nations to build confidence and trust. And importantly, the more budget rules follow similar patterns, the easier they will be to understand, both among policymakers and the public.

111. Can policymakers across nations be both realistic and ambitious in setting medium-term budget goals, and can they stick to long-term objectives of sustainability even when progress shows some apparent cause for celebration? Can they find components of their budget rules that they can share with, and borrow from, their neighbors? Can they agree on features of rule design that will avoid pro-cyclical tendencies, both requirements for constraint in downturns and also permissive spending increases and tax cuts when economies and budgets are strong? Can they build consensus to focus on spending and tax discipline, rather than targeting budget deficit numbers that they cannot control, and educate their publics as to the wisdom of that course? These steps will be essential to gain fiscal control and sustainability while we have some respite from the recent years of deterioration because of fiscal risks.

## 4. Conclusion

112. The speed of the budget deterioration in this new millennium has been breathtaking. A budget world that at times blamed its poor performance on failures of budget process has been beaten about the head and shoulders by all manner of unlikely exogenous shocks – and ironically finds itself in serious need of budget process again. And after all of those alleged budget process failure were assigned to excessive complexity, and budget critics cried out for more clarity and transparency, the millennium’s cruel slings and arrows of outrageous fortune have most unfortunately rendered the task of budget process unavoidably more complex.

113. Our current predicament could fairly be characterized as unprecedented; but we have seen the key individual pieces of this puzzle before. An optimistic view is that we need only to put the pieces together. Nations must find the elements of budget rules that will take incremental component steps to reach feasible consensus targets for deficit reduction, while incorporating preventive investment and contingency reserves for any future recurrence of realized budgetary risks. Sustainability must be coupled with growth.

114. This task will not be easy, and the stakes are high. But by borrowing lessons from recent history and from each other, we have a real chance of success – if, further, nations can summon the patience and the creativity to build the fiscal rules they need, and the will to take the difficult steps that those rules dictate.