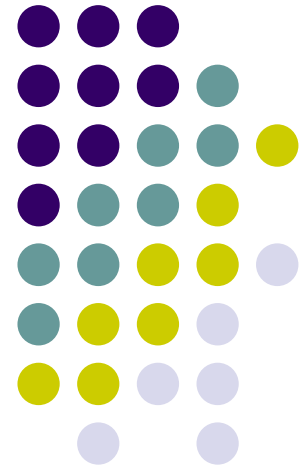


CRISIS BUDGETING

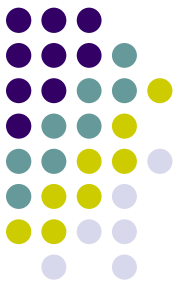
ALLEN SCHICK

ANNUAL MEETING SENIOR BUDGET OFFICIALS

OECD, PARIS 4-5 JUNE 2009

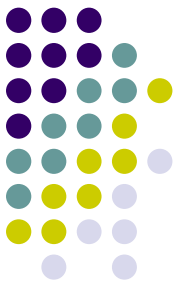


CRISIS BUDGETING IS DIFFERENT



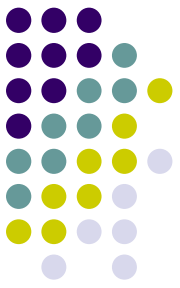
- Key decisions differ from those made in normal circumstances
 - Adjustments tend to be large and frequent
 - Government uses nonconventional means to stimulate the economy or assist distressed enterprises and households
- The process deviates significantly from established budget procedures
 - Political leaders bypass the process to expedite action
 - Budget actions are not incremental: the previous year's expenditure does not strongly influence what government does in crisis
- Decisions and procedures devised for crisis will impact budget policies and practices after the crisis passes
 - Many governments will have elevated debt burdens
 - Responses to the crisis may establish precedents for how governments budget in normal times

MANY OECD GOVERNMENTS HAVE USED CONVENTIONAL BUDGET TOOLS TO EASE ECONOMIC DISTRESS



- Automatic stabilizers that reduce revenues and boost spending have been the first response
 - These stabilizers have turned surpluses into deficits in some countries and enlarged deficits in others
 - In most OECD countries, stabilizers which suffice during recessions have not sufficed during the current crisis
- Many governments have supplemented the stabilizers with new grants to households or enterprises
 - In some countries the government has acquired assets (such as shares in distressed firms) or ownership of recapitalized financial institutions
 - Valuing these assets and consolidating them in the budget entails difficult accounting issues
 - The cash and accrual basis differ in how they account for government acquired assets

GOVERNMENTS LOANS TO ENTERPRISES POSE SOME DIFFICULT ACCOUNTING ISSUES



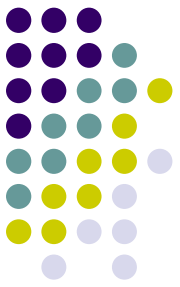
- Loans often are an efficient form of assistance to viable firms that lack access to credit during the crisis
- In the cash basis, loans generally are recorded as expenditures: the actual cost is irrelevant
- By overstating expenditures when loans are made, government cannot recognize cost if loans are forgiven or defaulted
- The United States budgets for loans on a subsidy cost basis
- This method takes account of interest rates, estimated defaults, and recovery of assets.
- Because of economic turbulence and the size of some loans, it is difficult to estimate future losses

SOME GOVERNMENTS HAVE PROVIDED GUARANTEES TO ENTERPRISES



- Because they do not result in immediate outlays, guarantees and other contingent liabilities are not recognized in cash budgeting
- During the current crisis, governments generally have issued explicit guarantees that specify their obligations in case certain adverse events, such as default, occurs
- Some governments are exposed to implicit guarantees when there is pervasive expectation that government will offer assistance, even when it is not legally obligated
- Guarantees have characteristics similar to loans: risk is concentrated and difficult to measure in current circumstances
- Guarantees are especially difficult to value when risk is systemic, and is not determined by the condition or actions of the enterprises receiving the guarantees

SOME GOVERNMENTS HAVE ESTABLISHED EXTRABUDGETARY ENTITIES



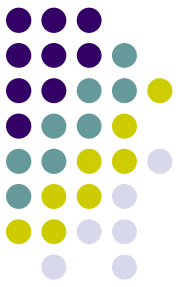
- Extrabudgetary entities are established for two very different reasons:
 - (1) To operate business-like activities on behalf of government, and**
 - (2) To exclude certain transactions from the budget**
- Extrabudgetary agencies generally have greater operating independence than is accorded on-budget agencies, especially when they generate trading income.
- There is a tendency for extrabudgetary entities to survive after the purposes for which they were created have passed
- Special entities established by government to manage assets or enterprises acquired during crisis may be financed by trading revenue, asset sales, borrowings, or capitalization by government

SOME CENTRAL BANKS HAVE ACTIVELY PARTICIPATED IN PROVIDING FINANCIAL ASSISTANCE



- Despite legal independence, some central banks have closely coordinated stimulus and bailout actions with government
- Several crisis conditions have induced central banks to go beyond their normal activities to engage in quasi-fiscal operations
- With interest rates charged banks close to zero, central banks lack capacity to stimulate the economy by reducing rates
- When credit markets are frozen or illiquid, conventional stimulus may not achieve the intended effects
- The surge in public debt may give rise to concern as to the capacity of private lenders to absorb the added debt
- Central bank fiscal activities include loans to nonfinancial enterprises, purchase of government bonds, and purchase of home mortgages, credit card debt, and other assets
- These types of central bank activities have given rise to two concerns: Its operating independence may be compromised: and actions taken during crisis may generate inflationary pressure when the economy recovers

THE ECONOMIC CRISIS HAS AFFECTED FOUR CHARACTERISTICS OF BUDGETING



- Procedures used in allocating budget resources
 - Key routines of budgeting have been bypassed or altered
- Distribution of budgetary power
 - Power has migrated from those who manage the process to those who manage the crisis
- Crisis-driven allocations are not incremental
 - They tend to be very large and are not determined by past allocations
- Crisis budgeting requires new means of containing budgetary conflict
 - The usual means of limiting conflict may not be available during crisis

THE LEGACY OF CRISIS: POLICY IMPACTS



- All OECD countries have been impacted by the global recession
 - Stagnant or declining GDP has diminished revenue and produced budget deficits
- Some countries will have only small aftershocks and will resume normal budget practices and policies soon after economic growth resumes
- But countries that have had large declines in GDP and have adopted expensive stimulus programs will have elevated debt burdens long after the crisis has passed
- Debt service will claim a rising share of public expenditure in these countries
- To offset these expenditures and trim deficits, some governments will adopt austere budgets, but (if past experiences are a guide) most cuts will be marginal
- The trend to lower tax rates will be reversed in some countries

THE LEGACY OF CRISIS: BUDGET PROCESS



- National governments, international organizations and regional institutions will renew interest in fiscal rules that constrain deficits, debt or other budget aggregates.
 - Next generation rules will be more sensitive to structural and cyclical variations in fiscal outcomes
- Governments will give increased attention to long-term sustainability of their budgets
 - Sustainability analyses will be more closely integrated with ongoing budget work
- Governments will devise new means to measure and monitor fiscal risks
 - Some innovative governments may adopt rules that recognize the cost of risks in their budgets
 - Governments may adopt rules that inhibit taking on certain risks
- International cooperation and enforcement will be strengthened
 - Over time, rules may be introduced to standardize certain types of budget accounting