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Budgeting for Entitlements

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An entitlement is a provision of law that establishes a legal right to public funds. In most OECD countries, entitlements were the principal growth area of public expenditure from the mid 1950s to the mid 1980s. This article discusses budgeting for entitlements under two rather different conditions: the expansion of this category of expenditure during the quarter century after World War II, and cutback and "status quo" budgeting during the decade since the first oil shock.

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During the past three decades, there has been a progressive enlargement in the relative size of the public sector in most OECD countries, as well as significant changes in the composition of public expenditure. Public expenditure averaged 28.5% of GDP in the 1955-57 period, 34.5% in the 1967-69 years, and 41.4% in 1974-76 (OECD, 1978, Table 2; these are unweighted averages). This enlargement has persisted in recent years, though the rate of growth has been slower and more erratic (OECD, 1982, Table 4-A-C). According to a 1982 OECD study for Working Party No. 1 of the Economic Policy Committee, "except for Australia, Austria, Luxembourg and Iceland, the most buoyant source of public sector growth during the reporting period as a whole [1960-80] has been the increase in transfer payments. [...] Transfer payments are now roughly equal to public consumption expenditure in an increasing number of OECD countries" (OECD, 1982, p. 6). Data from a number of countries illustrate the growing importance of these payments. In Denmark, income maintenance expenditures climbed from 7.5% of GDP in 1954 to 19.7% in 1978. They rose in France from 11.2% to 17.9%; in Germany from 11.5% to 18.2%; in Japan from 2.9% to 7.3%; in the Netherlands from 6.4% to 19.4%; in the United Kingdom from 6.4% to 11.7%; and in the United States from 4.1% to 9.8% (OECD, 1982, Table 4-A-C).

These trends, the causes of which have occasioned much study and controversy, have been accompanied by a substantial increase in the share of public expenditure accounted for by entitlement programmes. The bulk of transfer and income maintenance expenditure is for pensions, unemployment and disability compensation, and other entitlement schemes. In most OECD countries, entitlements have been the principal growth area of public expenditure in recent years.

This paper discusses budgeting for entitlements under two rather different conditions: the expansion of this category of expenditure during the quarter century after World War II; and cutback and "status quo" budgeting during the decade since the first oil shock. Before discussing these conditions and the factors accounting for them, the paper provides an overview and definition of the entitlement problem.

1. The definition and budgetary status of entitlements

Despite their importance, there is no standard definition of entitlements nor, therefore, reliable means of measuring the fraction of the budget accounted for by them. Nevertheless, the budgetary characteristics of entitlements are sufficiently distinguishable from other forms of public expenditure to warrant separate analysis. Budgeting for entitlements is not the same as budgeting for the purchase of goods and services or for other discretionary expenditures. The differences between entitlements and more traditional expenditures account for the basic problem of expenditure management that besets most OECD countries. The methods of budgetary decision and management developed for traditional expenditures might require adjustment when applied to entitlement programmes.

An entitlement is a provision of law that establishes a legal right to public funds. The right might be accorded to an individual, to a household, or to any other designated beneficiary. The law usually sets forth eligibility requirements and either a schedule of payments or a formula by which the payments are computed. The law usually does not specify (or limit) the total expenditure for the entitlement; the total is simply the sum of individual payments.

Social security, unemployment compensation, family allowances and disability payments are entitlements because they accord particular classes of the population rights to money from the public treasury. The right to a social security benefit, for example, is based on age and (in many countries) prior earnings, and the money value of that right is determined according to law. The government (or the social security fund) is obligated to pay the amount to which recipients are entitled whether or not sufficient funds have been set aside for this purpose in the budget. In many countries, a permanent appropriation finances social security and various other entitlement programmes. But even when the entitlement is financed by annual appropriations, the government must provide the benefits mandated by law.

The concept of entitlements can be explicated by contrasting them to other types of expenditure. Programmes which are not entitlements entail either discretionary expenditures or mandatory expenditures. The former are easily distinguishable from entitlements because expenditures are incurred only if they are authorised by appropriations. There is no substantive law requiring the government to spend the funds and no right of recipients to payments from the treasury. If no appropriation is forthcoming, no expenditure is made. Discretionary expenditures are common in the purchase of goods and services. However, in instances where suppliers have a legal right to sell their goods to the government and the government is obligated to purchase those goods at a price determined according to law, then an entitlement would exist. Thus, agricultural programmes which require the government to acquire surplus crops at a price set by law would be entitlements. But when the government spends an appropriation to purchase agricultural products to feed persons in its care, the expenditure probably would not be an entitlement.

The second category consists of mandatory expenditures which are not entitlements. In these cases, the requirement to incur the expenditure arises out of a contractual obligation entered into by the government. Thus, the obligation to pay interest on its debt stems from a contract between the government and bondholders; a government's obligation to pay for goods and services derives from a contractual commitment to suppliers. Without these contracts, no payments would ensue. But the obligation to pay for entitlements derives from law, not from contract. Indeed, many entitlements are unilateral commitments by the government which do not require any reciprocal commitment by beneficiaries.

The distinction between entitlements and other expenditures is not so clear-cut as to rule out all ambiguity. Some programmes may have characteristics similar to entitlements but still permit a measure of discretion in determining expenditure. In the United States, for example, the food stamps programme entitles low-income persons to cash assistance for the purchase of food. Because the law establishing the programme limits the total cost and makes expenditures conditional on annual appropriations, some budget experts do not regard food stamps as an entitlement. Yet Congress always appropriates sufficient funds to pay for all required benefits and raises the limitation on total cost whenever necessary to ensure that all benefits are fully paid. For this reason, some experts classify food stamps as an entitlement.

Ambiguity about the status of some programmes does not impair the analytic usefulness of the entitlement concept. Most expenditures can be clearly classified as entitlements or non-entitlements. The marginal cases make it difficult to tally the full cost of entitlements or their share of national budgets. But to examine how the practice of budgeting has been affected by the growth of entitlements, one need not possess an authoritative listing of these expenditures.

The critical distinction between entitlements and non-entitlements is that expenditures for the former are determined by law and for the latter by budgets and appropriations. When entitlement legislation is being formulated, its future cost can only be estimated; once the legislation has been enacted into law, the government must (unless it changes the law) bear whatever cost is required by the entitlement. In these circumstances, the budget process is more a means of accounting for past decisions than of making new ones. Moreover, the budget may not be the process by which year-to-year changes in entitlement expendures are determined. These changes are more likely to result from changes in the number of eligible beneficiaries and from inflation than from discretionary budget actions. As a consequence, budgetary control of the "increment" – the portion of expenditure over which the budget organisation historically had greatest influence – has been weakened. In extreme cases, where indexation is widespread and entitlements are highly sensitive to economic performance, expenditure growth is on "automatic pilot" and the procedures of budgeting have little sway over the trend in expenditure.

In some countries, entitlement expenditures are classified as "uncontrollable". This label should be interpreted to mean that the level of expenditure is not determined by a budget decision alone. That is to say, if the budget and appropriations do not provide sufficient funds, the government still is obligated to make the payments prescribed by law. But entitlements are controllable through changes in law; in this sense, the "uncontrollable" label can be misleading.

The fact that entitlements now constitute a much larger share of public expenditure than they did 10-30 years ago has important implications for budgeting. For one thing, unless it changes the law, the government must incur the expenditure, regardless of the condition of the economy or of other claims on the budget. Moreover, as noted above, year-to-year increases in expenditure are likely to be decided independently of the budget process. In fact, variations between budgeted and actual expenditures are likely to be greater and less predictable for entitlements than for other programmes.

Entitlement issues tend to draw wider participation both within and outside government than do conventional budget decisions relating to consumption expenditures. Conventional budgeting has been described as "government talking to itself", as ministries communicate their spending wants to the budget organisation. Taking decisions for entitlements is likely to be a more open process, for the affected beneficiaries have a direct stake in the outcome and strong incentives to make their interests known to public officials. Furthermore, the distributive effects of entitlements are more visible than are those of consumption spending.

This "politicisation" of budgeting poses few difficulties when the economy is growing and resources are available to finance increased entitlements. But when the economy is weak and cutbacks are sought, the budget process may have difficulty coping with political conflict over entitlements.

2. The establishment and growth of entitlements

No single factor accounts for the prominence now accorded entitlements in public expenditure. Budget officials attribute the growth in entitlements to economic conditions, political pressures, demographic changes and other factors. In sorting out these factors, it would be useful to distinguish between the establishment of entitlements (including changes in law expanding eligibility or benefits) and the growth that occurs after the entitlement has been enacted into law.

2.1. The establishment phase

In most OECD countries, the great upsurge in entitlement legislation occurred during the sustained period of economic growth in the decades after World War II. There is widespread agreement that the two conditions were closely related. Economic betterment provided the means of financing entitlement programmes, as well as expectations that the state would shelter its citizens from the fluctuations of the business cycle. Protracted growth legitimised the role of democratic regimes in economic stabilisation and management, and entitlements provided built-in stabilisers against cyclical downturns. Because the post-war growth occurred while memory of the Great Depression and its harsh effects was still strong, it stimulated demands for "safety nets" to assist less fortunate citizens. Widespread affluence (and the expectation of sustained improvement in the standard of living) generated political acceptance of income redistribution schemes, for it now was possible to improve the welfare of low-income persons without lowering the economic quality of life for the more fortunate sectors of society. Governments did not so much redistribute income as distribute the rewards of economic growth. They gave some of the benefits of growth to the elderly, the unemployed, the disabled and others who were cut off from it, but the living standards of workers and businessmen continued to improve.

Economic growth relaxed budgetary constraints on programme expansion and desensitised governments to the costs of their new obligations. Often, entitlements were inaugurated or expanded with little solid data on their future costs and without subjecting them to rigorous budgetary review. Insensitivity to the cost of new entitlements was partly a function of the manner in which these programmes were developed. Entitlement schemes were frequently devised by special task forces or commissions which operated outside the regular budget process and whose proposals garnered a great deal of attention and support before the ministry of finance was called upon to review them. The legislation formulated in response to these political expectations addressed the needs and rights of the persons who were to receive the entitlements. Unlike appropriations, money usually was not mentioned at all. Attention thus was deflected from costs to needs, and there was a parallel shift in the effective locus of decision making from the budget organisation to other centres of political power. It was difficult in these circumstances for budget officials to make their case in terms of costs. As a result, budgetary power gravitated to those who could point to the public good that would be accomplished by aiding the aged, the poor and the unemployed, and away from those who worried about whether the government could afford the obligations it was assuming so willingly.

Inattention to future costs was encouraged by a number of factors. First, the expectation of sustained growth bred confidence that an expanding economy would be able to pay for expanding benefits. Second, some major entitlements, particularly social security, had self-financed funds which accumulated surpluses to pay for future benefits.

These surpluses encouraged the notion that, despite demographic trends, the funds would be able to pay for the obligations which they were accruing. Third, during periods of economic weakness, the prevailing view was that spending on entitlements would spur recovery and lead to still greater improvements in living standards.

The spread of entitlements was fueled by peer pressures among the industrialised democracies. While the pattern and level of benefits varied from country to country, most were swept along by the rising expectations about their role in providing for the elderly, assisting the poor and protecting workers against recessions. A senior budget official of one less economically advanced European country suggested that its membership in the EC impelled it to upgrade the entitlements accorded citizens.

If economic growth was the wellspring of the entitlement state, then one should find entitlements to be less extensive in OECD countries that had low growth rates in the post-war era. There is reason to believe this to be the case in some southern European countries. But some of these countries have undergone rapid democratisation in recent years, opening them to intense pressures for enhanced living standards. One response has been to entitle citizens to various benefits. The Spanish government, for instance, recently enacted legislation entitling veterans of the Civil War (and certain of their relatives) to pensions, a programme which has turned out to be more costly than expected. This is due to the difficulty, common to many such benefit programmes, of establishing reliable estimates as to the number of persons who will claim and qualify for benefits.

Once started, entitlement programmes tend to be expanded. Programmes targeted for particular beneficiaries are broadened to cover additional groups. In the United States, for example, a programme designed to aid coal miners disabled by black lung disease was expanded by legislation to cover virtually all miners. In Sweden and other countries, programmes aimed at impoverished regions were expanded to other areas which did not meet the original eligibility requirements. These examples suggest that even if eligibility is narrowly defined, political forces may be set into motion to expand the entitlement beyond its intended scope. In this way, targeted programmes are incrementally transformed into universal ones, and entitlements which entail modest costs at the outset grow into costly undertakings.

Because the process of expansion is incremental, it is easy to lose sight of the entitlement's original purpose and of its future cost. Each proposed enlargement is considered in isolation, without examining why the programme was cast as an entitlement. At the point of expansion, the issue is often framed in terms of equity: why should one group be denied benefits which are already provided to another similar group? The affinities between those receiving and those denied the entitlement are accented, while the differences are downplayed.

OECD studies show that the expansion of entitlements entails both the extension of coverage and the improvement of real benefits (OECD, 1983a). Between 1960 and 1980, the percentage of the civilian labour force covered by unemployment insurance programmes increased in five major OECD countries and declined in only one. Coverage expanded from 63.6% to 89.6% in Canada; from 38.2% to 58.8% in France; from 38.2% to 47.7% in Italy; from 33.5% to 50.4% in Japan; and from 66.5% to 89.5% in the United States. There was a decline in the United Kingdom. During the same period, real benefits paid to unemployed workers increased in all of these countries (OECD, 1983b, Tables 16 and 17).

During the growth era, there were frequent adjustments in nominal payments to protect recipients against an erosion in their benefits due to inflation. Inasmuch as economic growth was robust, there often was widespread support for these adjustments, but public officials also were pressured to increase real benefits as well. Typically, therefore, inflation adjustments opened the door to other improvements in entitlements and, as a result, many OECD countries experienced a "benefits creep" with entitlements claiming a progressively larger share of state budgets and national income. In response, some countries turned to indexation as a means of dampening pressure for improvements in benefits. With payments automatcially linked to the inflation rate, there no longer would be need for periodic discretionary legislation. Beneficiaries could no longer use the occasion of inflation adjustments to obtain real improvements. Indexation protected politicians against programmatic pressures that they might not have been able to resist.

In addition to serving as a control mechanism, indexation was welcomed as a means of ensuring that the redistributive features of entitlements were maintained. In a few countries, benefits were linked to wages, thereby ensuring that recipients would partake of the expected economic growth.

2.2. Growth without legislation

The initiation and expansion of entitlement programmes through new legislation slackened after the first oil shock, as most OECD countries attempted to adjust to adverse economic conditions. But the cost of existing entitlements continued to rise because of factors over which governments had little or no control. Demographic trends, in particular the rising portion of the population eligible for pensions, contributed significantly to increased expenditures. The changing age composition of the population meant that even if real benefits and eligibility standards were frozen, entitlements would consume increasing shares of public budgets.

Indexation – which (as noted above) was introduced to strengthen budget control – had the opposite effect during the stagflation that persisted from the mid 1970s until the early 1980s. The confluence of high inflation and high unemployment had a devastating effect on budgetary balance in countries where indexed entitlements were widespread. High inflation automatically raised public spending on these programmes; high unemployment diminished the resources available to pay for them. Because the price level was the most commonly used index, beneficiaries of entitlements often were able to maintain their standard of living at the same time that the real income of workers declined.

Not only did low economic growth and high unemployment erode the revenue base of OECD countries, they also added to entitlement spending. Governments were obligated to provide the unemployment benefits they enacted during the growth years. But now that stagnation took hold, they found themselves locked into much higher expenditures than they had expected. One reason was that unemployment was much higher than in previous post-war recessions, compelling industrialised countries to spend much more than in the past to meet their commitments. Moreover, unemployment did not recede to the pre-recession level during recovery. Much of the unemployment was structural (due to the loss of jobs in declining industries and the incapacity of the economy to absorb large numbers of new entrants into the workforce) rather than cyclical. Structural unemployment burdened contemporary governments with high expenses with little prospect of relief from economic improvement.

If any of the three factors (demographic trends, indexation or unemployment) had occurred alone, the effets on government budgets might have been modest. But all three occurred in tandem during the past decade, greatly overloading the budgets of OECD countries and impelling them to seek means of moderating the rise in entitlement expenditures. The statutory basis of entitlements means, however, that governments cannot limit spending simply by budgeting and appropriating lower amounts for them. To cut back on entitlements, they must make substantive changes in law.

3. Curtailing the growth in entitlements

Economic malaise and dire forecasts of protracted budget crisis have virtually halted the establishment of entitlements. But OECD countries have not reduced actual spending; rather, they have sought to curtail the growth in entitlements. Entitlements are likely to remain prominent components of government budgets for many years, and the major income support programmes are likely to retain their basic features. Benefits might not be as high as they would be without cutbacks, and coverage might be narrower, but fears that governments will abandon their role in stabilising incomes have no basis in fact. Yet fear of abandonment is very real, and it has inhibited some governments from coming to grips with the entitlement problem. When small cuts in existing programmes spawn protests that the government is retreating from long-established commitments, the better part of political discretion may be to do nothing.

The conclusion that entitlements are here to stay (though not necessarily as prominent as they became during the growth era) is based on more than political considerations. Over the years, dependence on income supports has spread to most sectors of the population. Entitlements are costly because they are broadly available. Indeed, it is the middle class that garners the lion's share of the benefits in most industrialised democracies. It would be unthinkable to cast those who have become dependent on regular paycheques from government entirely onto their own means. There would be enormous economic dislocation, and the possibility of collapse could not be ruled out.

Thus far, the governments of OECD countries have sought marginal cutbacks in the growth rates of entitlements. While more far-reaching retrenchments might be attempted in the future (especially if economic crisis persists), marginal adjustments are likely to be the near-term objective of most budget and finance organisations. The reason is that these organisations are not motivated by long-term efforts to redefine the scope of government, but by an immediate need to redress the imbalance between resources and expenditures. Small cutbacks can produce visible and significant savings in the current and forthcoming budgets and can narrow the gap between revenues and expenditures. These small adjustments might not appear to aggregate to significant redirections in government policy. Transfer payments might still be the largest (and fastest-growing) component of public expenditure. But from the standpoint of budget officials, the marginal savings will be sufficiently large to make the effort worthwhile.

The marginal character of these cutbacks has generated a great deal of political confusion and budgetary opportunity. In many cases, a reduction in entitlements is accompanied by an increase in expenditure for the programme. This anomaly is due to the fact that the reduction often is calculated not in terms of past expenditure (the way reductions are normally computed in budgeting for consumption expenditures) but in terms of what the expenditure level would be without the cutback. Thus, if spending for an entitlement were above the previous year's level, a change in the programme could still be regarded as a cut. This situation can breed confusion and controversy over the size of the cutback, but it also enables politicians to take credit for both programme reductions and increases. They may thereby respond more easily to the conflicting pressures confronting government: to cut spending and to increase programmes.

3.1. The tactics of cutback

It is relatively easy to mobilise opposition to cutbacks. Because entitlements provide cash (or equivalents), cutbacks are more directly felt than when services are curtailed. Reductions in transfer payments have the same financial impact on beneficiaries as reductions in pay have on workers. In both cases, there is a visible loss in disposable income. Accordingly, governments have found it necessary to implement cutbacks with great care and sensitivity to the potential responses of beneficiaries. In this environment, tactical aspects of budgeting – such as how the cutbacks are presented to the public and the position of the budget organisation *vis-à-vis* spending ministries – have become quite important. The tactics vary from one budget season or political situation to another, their commen element being an opportunistic assessment of what is more appropriate for the objectives of the moment. In one year, the government might act without advance warning in the hope that the shock treatment will overwhelm opposition before it can be effectively organised. In another year, the government might try to build political support for its moves by consulting with affected groups or by openly discussing the problems that compel it to make cutbacks.

The tactics are likely to reflect each country's political culture. In Japan, where consensual budgeting is the norm, efforts have been made to gain support by spreading the burdens of cutback among the affected strata. In Denmark, where coalition governments have fragile majorities in parliament, there is extensive intra-party negotiation within government but, once decided upon, the cutbacks are implemented "by storm". In the United States, Congress has an extraordinary degree of independence, and the president has felt it necessary to appeal for public support through the mass media.

Because of the shifting and opportunistic character of these tactics, governments have made few structural innovations in budgeting to deal with the entitlement problem. Canada's far-reaching Policy and Expenditure Management System (PEMS) is principally designed to deal with discretionary resource allocations, not with expenditure mandated by "statutory authority" (a category comprised mostly of entitlements), though the new system can affect the latter. Yet there have been two significant patterns in budget practice that might harbinger future structural changes. One is the tendency noted by Daniel Tarschys to rely on "packages" rather than on standard budget submissions to propose and implement important changes in expenditure policy. The other is to restore to budget organisations and finance ministries some of the power yielded to programme innovators during the growth era.

Packaging has a number of advantages for those who seek curtailment of entitlements. One is that it enables the government to group together a number of cutbacks and to thereby demonstrate that the burden of restraint is widely (and fairly) distributed. Another advantage is that packaging enables the government to insist that all the cutbacks be acted on as a unit, thereby weakening opposition to individual reductions and making it easier for politicians to support the whole package. In coalition governments, formulation of the package has become the focal point of negotiations among political parties and the test of the government's strength and durability. In the

United States, a packaging technique known as "reconciliation" has been effectively used to enact huge reductions in entitlements and other programmes.

Packaging has been used in the Netherlands and the United States to make multi-year reductions in entitlement programmes. Unlike the regular budget process which is geared to annual decisions, a package can schedule cutbacks to take place over a number of years. The ability to phase in reductions can make them more acceptable to affected parties while ameliorating the disruptions which might occur if all were implemented at once. However, multi-year packages tend to "age" as the government continues in office and opposition has time to mount an effective campaign. The initial perceptions or conditions which gave rise to the multi-year reductions may change or be proven incorrect, making it necessary to revise the package. Thus, one-year-at-a-time cuts imposed by blitzkrieg are likely to have a higher success rate than multi-year cutbacks implemented over several years. The Danish government obtained 90% of the cutbacks it proposed; the Netherland and the United States had lower rates of implementation.

Whatever its advantages, packaging can be disruptive of budgetary routines. The budget cycle can become irregular when big, controversial packages have to be negotiated, adjusted and implemented. It can become difficult to maintain the timetable for the various actions to be taken in the course of a year. But this problem, which has afflicted a number of countries, may be due more to political instability, fiscal stress and tactical considerations than to the packaging technique itself.

The determination of governments to curtail the growth in expenditure has led to potentially important shifts in the balance of ministerial power. Just as the impulse to expand programmes once enhanced the influence of spending ministries at the expense of the budget organisation, retrenchment has recently induced governments to rely more heavily on the recommendations of finance officers. Both the pro-spending shift during the growth era and recent curtailments were accomplished largely through informal changes in budgetary practice, such as in the access of ministers to the head of government or in the influence exercised by various ministers in the cabinet. But there have been some formal changes such as legislation requiring all ministerial spending proposals to be reviewed by the ministry of finance before submission to parliament. In fact, sensitising government officials, politicians and other interested parties to the prospective cost of entitlements has been one of the tactics used by budget organisations to bolster their own position and to constrain spending demands.

Expectations about the future course of spending are an important element in the contest between budget and spending ministries. If it is taken for granted that spending will continue to rise or that higher expenditure is legitimate and sustainable, then budget officials will be in a weak position to resist the demand emanating from spending ministries and from interest groups. A key task of a budget organisation bent on curtailing expenditure growth is to alter expectations about the future. One means of doing this is to disseminate "bad case" scenarios of the budgetary imbalance that the government will face unless it cuts back the automatic growth in entitlements. Multi-year projections have led to multi-year retrenchments in some countries and have been formidable inhibitors of expansion in others. In virtually all OECD countries, expectations of future growth are significantly less buoyant and less legitimate than a decade ago.

If fiscal stress and expectations of future shrinkage become entrenched, modifications in budgetary practice may become more structural and systemic than has been the case thus far. Rather than relying on tactical and behavioural features of budgeting to constrain expenditures, governments might seek more wide-ranging adaptations. The fact that this has not happened thus far might be due to: *i)* uncertainty about the future course of budgeting; *ii)* the persistence of growth expectations despite recent cutbacks; or *iii)* attention to short-term tactical problems. In any case, no consensus seems to be emerging on the types of structural change that might be appropriate.

3.2. Types of cutbacks

Mention has been made that the cutbacks implemented thus far have tended to be marginal and that their aim has been to curb the rate of growth, not to reduce actual spending levels. Although they may be marginal relative to the total volume of expenditure, these cutbacks can incite a great deal of political strife. Hence, budget officials have sought cutbacks which can save money without generating intense conflict. They often have curtailed expenditures in ways that do not cut programmes directly. That is to say, although financial cuts have programme implications, they can hide programme effects.

Examples of these types of cutbacks can be drawn from various countries. Denmark froze benefit levels for two years and did not adjust them for inflation. Finland engineered delays to postpone expenditure; the United States did likewise by delaying inflation adjustments for three to six months. It also saved an estimated USD 3 billion over a five-year period by rounding benefits down to the next lower dollar. Ireland established a waiting period for eligibility and reduced real benefits in some entitlements from 45% to 25% of employment pay. These financial modifications saved money without making structural changes in the affected programmes.

Financing modifications can be a form of across-the-board reduction in which all beneficiaries suffer some loss regardless of their particular circumstances. Like across-the-board cuts, they veil the effects on programme levels and convey a sense that the burden is being fairly borne by all affected parties. But like across-the-board cuts, they might actually be very unequal in their effects.

Marginal changes have been made in eligibility requirements to curtail expenditure growth. The duration of eligibility can be shortened (or limited), standards for determining eligibility can be narrowed, some groups can be excluded altogether, or a waiting period can be established before recipients become eligible for benefits. The Netherlands excluded some young people from unemployment benefits; the United States purged the disability lists of persons judged capable of working. From the perspective of government, these marginal changes are attractive because they save money without impairing the eligibility of most beneficiaries. As with the financing changes described above, the savings are realised but the basic structure of the programme remains intact.

Governments have sought to curtail expenditure growth through marginal adjustments in entitlement formulas. One such adjustment is to change the index – for example, from wages to prices, or to the lower of the two. Another is to shift from full to partial adjustment for inflation. Yet another is to lag the adjustment behind increases in inflation. However, little progress has been made toward complete de-indexation, perhaps because the propriety of compensating dependent groups for inflation is now widely accepted.

Marginal cutbacks produce marginal savings. It has already been noted that these might suffice for narrowing the revenue-expenditure gap to a politically acceptable range. Some observers believe that more drastic measures which would alter basic contractual and statutory commitments might be necessary in the future. This expectation has more to do with demographic trends (especially the ageing of the population) than with economic conditions. The argument is that, despite current trends toward economic recovery, the ratio of dependent to productive population will increase to such an extent as to make continuation of the entitlement state in its present scale untenable. If this outlook proves to be accurate, OECD countries will be tasked with much more difficult political and budgetary challenges than they have heretofore faced.

Afterword

In assessing the huge costs of entitlements, it is appropriate to step back from the particulars of the budget process and to focus instead on the social purposes served by these expenditures. After all, budget control is not the only value that governments must consider in designing public policy, nor is it always the more important. Governments purposely weaken the budget's capacity to determine expenditures because tight control clashes with other salient objectives. Most governments of OECD countries have weakened annual budget control by giving workers assurance about their financial wellbeing when they retire. The governments have established payment programmes to assist workers who lose their jobs, health care programmes to provide medical services or financial support to persons afflicted with illness, income support programmes for dependent people, and numerous other transfer programmes.

The values that underlie public entitlements are widely shared by citizens in all OECD countries. Of course, there is political controversy about payment levels and eligibility requirements, but these are marginal issues that affect the amounts spent, not the legitimacy of entitlements established in permanent legislation. Citizens may not favour every entitlement programme, but the bigger the programmes are, the more support they garner in public opinion polls.

If governments had perfect budget control, each year's budget would be unencumbered by past entitlement decisions; no legal commitments would carry over from one year to the next. Governments would annually decide how much to spend on pensions, low-income support, medical care, unemployment compensation and other forms of assistance. The budget would be restored as the means of allocating public money.

However, a world of perfect budget control would not be a perfect world. Social insecurity would be widespread. Workers and households would face an uncertain financial future. Pensioners would have to wait for each year's cycle of budget decisions to find out what their disposable income would be. A strong case can be made that society is better off because of the entitlement regime in place. These pre-decided payments cushion households against the cyclical shocks of recession and the secular shocks of old age and disability. They ease anxieties about inflation, unemployment, illness, and the affordability of health care. Entitlements should be seen as the pooling of financial risk in the largest pool that a country can construct on its own – the whole of society.

Yet, arguing that entitlements do much social good does not mean that all such spending is equally worthwhile, or that all features of these spending programmes are worth the cost. Governments can restore some budget control by periodically subjecting entitlements to scrutiny and by adjusting benefits. In fact, some national governments with the most sustainable fiscal positions have made significant changes in benefit schemes to reduce their long-term exposure.

In principle, entitlements are not compatible with budget control; in practice, the two must be reconciled. The first step in harmonising the need for budgetary discipline and the social need for financial security is for governments to be cautious in undertaking new entitlements. This is especially critical for the newly emergent economies that do not yet have full Western-style entitlement regimes. The second step is to make marginal adjustments that enlarge the increments available for allocation through annual budget decisions. It must be recognised, however, that even marginal changes can stir up political opposition. The third task is for governments to undertake an assessment of which risks can be transferred to private hands through various risk-sharing mechanisms. If governments fail to take these steps, they may be compelled by demographic pressures to move even more boldly in the future to curtail entitlements.

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