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Foreword

The *OECD Journal on Budgeting* is a unique resource for policy makers, officials and researchers in public sector budgeting. Drawing on the best of the recent work of the Committee of Senior Budget Officials (SBO), as well as special contributions from finance ministries of member countries and from other practitioners, the Journal provides insights on leading-edge institutional arrangements, systems and instruments for the effective and efficient allocation and management of resources in the public sector.

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Rise of non-standard policy Instruments: Can budgeting catch up?

Delphine Moretti, Senior Policy Analyst, OECD

For implementing their economic and social policies, governments have traditionally relied on direct spending but increasingly use “non-standard” policy instruments, such as loans and guarantees. However, in many OECD countries, loans and guarantees are not yet submitted to the same scrutiny than direct spending as part of the budget process, and future costs associated with the use of these policy instruments are often not estimated, nor provisioned, making them appear initially costless. In turn, this generates risks of potentially biased budgetary decision making, deviations from medium-term spending plans and limited transparency. Considering experiences of OECD countries, this paper advises that budget offices take a leading role in proposing budgetary treatments for loans and guarantees that ensure an even-level playing field with traditional spending and put considerations of efficiency of spending above optimisation of short-term fiscal outcomes.

JEL classification: H5 and H6

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Introduction

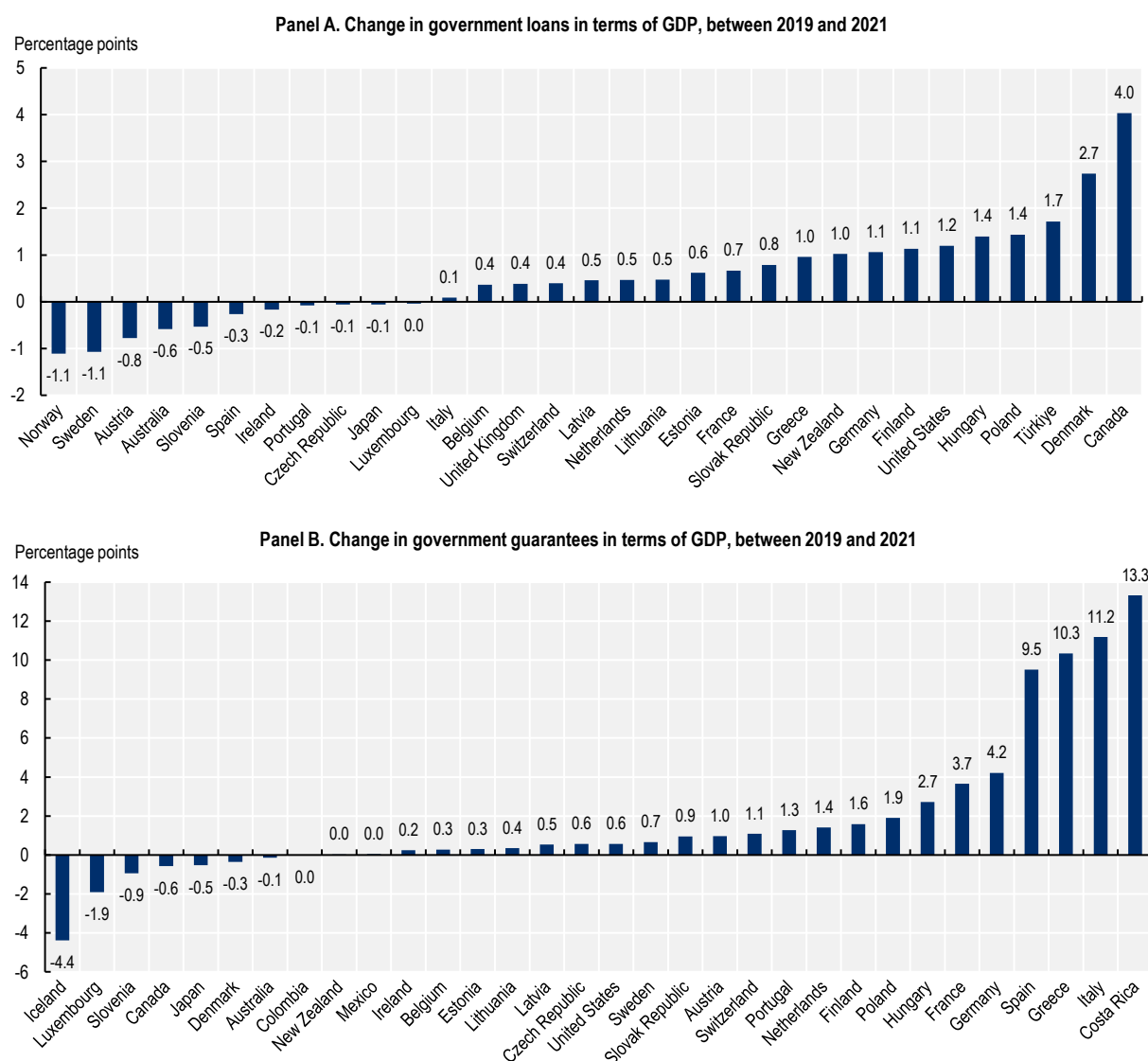
The rise of non-standard policy instruments

Governments have relied traditionally on direct spending, and more specifically on subsidies, for implementing their economic and social policies. However, other policy instruments have been developed over time to implement these policies, which are non-standard in that they do not rely on direct spending. They can take various forms, such as loans, guarantees, equity injections or tax expenditures. These non-standard policy instruments, which are a heterogeneous group, do not have yet a well-defined name. They have been branded different names, such as “alternative policy instruments” (Parliamentary Budget Office, Commonwealth of Australia, 2020^[1]), “balance sheet-based policies” (Moretti, Braendle and Leroy, 2021^[2]) or “financial support measures” (Battersby et al., 2022^[3]).

Within non-standard policy instruments, loans and guarantees deserve special attention. For several decades already, governments have carried out significant activity through loans and guarantees. These policy instruments were initially restricted to a few well-delineated areas, and mainly aimed to addressing market failures. During the global financial crisis and COVID-19 pandemic, however, they became many governments' tools-of-choice for crisis response (Moretti, Boucher and Giannini, 2021^[4]; Battersby et al., 2022^[3]), evolving in the process into common policy instruments for counter-cyclical fiscal policies during economic downturns. This was illustrated recently by the energy crisis, during which governments made significant use of loans to support utilities in meeting their liquidity needs (Sgaravatti et al., 2021^[5]). Further, loans and guarantees are increasingly considered as potential instruments for delivering new policy priorities, such as the green transition (e.g. concessional loans for building climate-resilient infrastructure).

Specifically, during the global financial crisis (GFC), some countries increased their loans and equity purchases by more than 4% of GDP and contingent liabilities, mainly guarantees, by more than 10% of GDP (Battersby et al., 2022^[3]). In most OECD countries, stocks of loans and guarantees were not brought back to their pre-GFC levels after the crisis. Further, during the COVID-19 pandemic, stock of loans increased again in several OECD countries, by more than 1 percentage point in terms of GDP for 10 OECD countries (Figure 1, Panel A). In addition, 13 OECD countries increased their stocks of guarantees by more than 1 percentage point in terms of GDP (Figure 1, Panel B).

Figure 1. Selected OECD countries: Change in stocks of loans and guarantees, 2019-21



Note: Panel A: Data for 31 OECD countries based on OECD statistics on loans for general government (710. Financial balance sheets – consolidated -SNA 2008, Transaction: loans). OECD countries not represented in this graph are those for which loans or GDP data was not available for 2019 or 2021.

Panel B: The figure is showing the difference between 2019 government guarantees as a percentage of GDP and 2021 government guarantees as a percentage of GDP. Direct comparisons can only be made between EU countries. For other OECD countries, the data is based on national definitions and methodologies, which may vary significantly from one country to another. The government guarantees data for EU countries refers to general government, data for Australia, Canada, Mexico, Switzerland and the United States refer to federal government and data for New Zealand refer to central government. OECD countries not represented in this figure are those for which loans or GDP data was not available for 2019 or 2021.

Source: Panel A: OECD staff estimates based on [OECD.Stat](https://data.oecd.org/); Panel B: OECD staff estimates based on government guarantees in national currency: Eurostat for EU member-states, national sources for other OECD countries; for GDP in national currency: OECD National Accounts Statistics (database) on 2 May 2023.

The rise of loans and guarantees as policy instruments is not always backed by strong evidence on their effectiveness vs. subsidies. For instance, a recent study recognises their usefulness in crisis episodes, but less so in economic downturns (Battersby et al., 2022^[3]). Some OECD countries have therefore sought to prevent their excessive use. For instance, the United States's long-standing policy is that "Federal credit programmes should be provided only when it is necessary and the best method to achieve clearly specified Federal objectives [and] use of private credit markets should be encouraged (...)" (Executive office of the President Office of Management and Budget, 2013^[6]). The Netherlands has had for several years a "no, unless" policy which requires that new proposals for guarantees be underpinned by a strong rationale (Hofmans and van de Coevering, 2014^[7]). Recently, the United Kingdom also sought to better regulate possibilities for using guarantee schemes (HM Treasury, 2020^[8]).

A new paradigm for budget systems

As loans and guarantees' effectiveness as policy instruments is not easy to demonstrate, this raises the question: why are they increasingly used? Part of the answer might lie in the fact that they "evade" the standard budget process and scrutiny. This is because, in essence, most OECD countries' budget systems have been designed to manage the standard policy instrument of governments – that is direct spending. When a new subsidy is voted for the next fiscal year, the budgetary implication is clear: cash outflows will incur over that fiscal year. This will be easily captured in a cash-basis budget, which is largely prevalent for managing appropriations in OECD countries.¹

However, with non-standard policy instruments, things are more complex. Firstly, budgetary implications of new economic and social policies are more difficult to measure: guarantees and equity injections may generate delayed cash outflows (calls on guarantee and recapitalisations), loans may generate indirect cash outflows (difference between concessional interest rate and government's own financing rate), loans and tax expenditures may reduce cash inflows (payment defaults and revenue losses). Secondly, these budgetary implications are impossible to trace in a cash budget, making them initially, and mistakenly, appear as costless.

Budgetary issues associated with non-standard policy instruments are well known and a few OECD countries, like the United States, have been pioneers in analysing and addressing these problems (Phaup, 1985^[9]).² However, the increasing use of loans and guarantees across OECD countries has not been systematically coupled with changes to national budgeting practices, making this issue more acute and urgent to address. For instance, in Australia, the Parliamentary Budget Office recently called attention to the fact that "if the use of alternative financing arrangements continues to grow without a change to reporting practices, a larger share of government spending would be difficult to scrutinise, which could pose risks to the Commonwealth Government's fiscal position over the longer term." (Parliamentary Budget Office, Commonwealth of Australia, 2020^[1]).

Objective of the paper

Against this background, this paper aims to provide an update on the OECD Secretariat's work on good practices for budgeting for government loans and guarantees, the groundwork for which was laid first in the OECD's 2015 *Recommendation of the Council on Budgetary Governance* (OECD, 2015^[10]) and subsequently developed in the OECD Spending Better Framework (OECD, 2023^[11]).³ It does not aim to discuss policy rationales and outcomes of government decisions to use loans or guarantees but to summarise key considerations for making loans and guarantees more legitimate as policy instruments from a budgeting perspective and advocates a stronger role for budget offices in this area. For doing so, it draws on discussions in recent meetings of the SBO and its Working Party on Finance Management and Reporting supported by specific country examples, as well as OECD Secretariat's previous analytical work.

Principles of budgeting for loans and guarantees

In budgeting for loans guarantee, and more generally for any non-standard policy instrument, budgetary implications be made explicit in the budget documentation, with: i) costs estimated for the full life of the policy; and ii) fully funded in the budget (OECD, 2023^[11]). This aims to represent the “real” nature of the policy in the budget, which is to provide subsidy, rather than its form, which is a loan or a guarantee. It has been branded as budgeting “for subsidy cost” (Anderson and Burke, 2021^[12]), “for grant-equivalence” (Hong and Lucas, 2023^[13]) or “on a like-for-like basis” (Saxena, 2017^[14]).

This impacts budgetary decision making in three beneficial ways:

- First, the estimation of costs for the full life of the policy supports *informed* budgetary decision making by showing the real financial impact of policy instruments that would otherwise appear initially costless.
- Second, the recording of an appropriation to cover costs for the full life of the policy forces *responsible* budgetary decision making that considers trade-offs and priorities against a background of limited resources.
- Third, the recording of an appropriation, similarly to what would be done for a subsidy, creates a “level playing field” between policy instruments and allows *neutral* budgetary decision making where efficiency considerations are put above short-term optimisation of fiscal outcomes.

Although several OECD countries have sought to improve their budgeting approach for loans and guarantees, few are fully complying with the principles stated above. Some countries estimate costs for the full life of their loans and guarantees programmes, and record these in the government balance sheet as liabilities, but they do not record an appropriation for the corresponding amount. Rather, it is the estimated amount of cash outflows for the next fiscal year that is appropriated. Such an approach has obvious merits from an informed budgetary decision making and transparency perspectives. However, it does not create a level playing field with subsidies and is likely to perpetuate decision making bias in favour of non-standard policy instruments. Therefore, it does not fully prop up responsible and neutral budgetary decision making.

Scope of budgeting for loans and guarantees

In this paper, the generic terms “loans” and “guarantees” refer to: i) individual loans or guarantees granted to one third-party; and ii) standardised programmes extended to a group of individuals or businesses. In providing individual or standardised loans and guarantees, governments may take over or mitigate credit risks, insurance risks or other types of risks, such as demand risks.

Terminology used for designating loans and guarantees may differ across countries. For instance, in the United States, legislation uses the terms credit programmes to refer to both direct loans and loan guarantees aimed at aiding borrowers and insurance programmes to refer to insurance of deposits in financial institutions and pension guarantees.⁴ Other countries may use the vocabulary of international accounting standards (International Financial Reporting Standards, or IFRS and International Public Sector Standards Board, or IPSAS). In these standards, loans and guarantees are referred to as financial instruments, loan commitments, insurance schemes, provisions, and contingent liabilities.

Irrespective of the terminology favoured, it is important that fiscal legislation includes a taxonomy of loans and guarantees used by a government, describe the budgetary implications of each main category of loans and guarantees, and explain the corresponding budgetary treatment. For instance, in the United States and Sweden, legislation has been passed that explains the nature and scope of federal/government loans and guarantee and legislates the associated budgetary treatment. In Australia, government loans and

guarantees' taxonomy (e.g. the standards differentiate guarantees arising from legislative vs. contractual obligations) and their accounting treatment is determined in Australian Accounting Standards.

In principle, loans and guarantees should all follow similar budgetary treatment. However, in practice, government may provide for exceptions, which should be explained in legislation. Again, the United States provides a good example of this, as the exclusion of the deposit insurance programme as well as pension, crop, and flood insurance from the budgetary treatment applied to other credit programmes has been explained at the time of the Credit Reform Act's adoption (Anderson and Burke, 2021^[12]).⁵

A key issue with regards to budgeting for loans and guarantees is in relation to how to deal with non-budgetary entities that manage government credit programmes. For instance, in Japan, during the COVID-19 crisis, government-affiliated and private financial institutions have been used to provide concessional loans and guarantees to small and medium-size enterprises (OECD, 2022^[15]). Several other OECD countries similarly rely on public corporations to manage government credit programmes. Depending on the institutional scope of the budget, the fiscal implications of such loans and guarantees schemes will therefore be captured in different ways in the appropriations. For instance, in the case of Japan, subsidies to financial institutions to cover the estimated costs of credit programmes are recorded in the budget, but this does not allow tracking the actual costs of these programmes.

Another issue is in relation to “implicit contingent liabilities”. These are obligations that a government may feel obliged to fulfil for political or moral reasons in the absence of any contractual or legal obligation to do so. By virtue of being implicit and revealed only at the time when some crisis unfolds, these contingent liabilities are unbounded, imprecise, and therefore particularly difficult to identify and measure (Lindwall, 2013^[16]). However, they regularly crystallise. For instance, when the stability of a country's financial system is at risk, governments will likely feel obliged to provide financial support to banking institutions that far exceeds their legal obligation as evidenced by recent bailouts.

Whether financial implications of: i) loans and guarantees administered by non-budgetary entities; and ii) government implicit guarantees should be estimated and funded in the budget is not a settled question. In the case of implicit guarantees, some argue that the sheer scale of the financial sector in some OECD countries would make such an approach difficult to justify and even more difficult to implement, in addition to creating substantial moral hazard. Others highlight the risk that credit programmes be deliberately placed under the management of entities outside of the budget for fiscal rather than efficiency reasons (Heald, 2023^[17]). Therefore, where the budget's institutional scope and rules fail to account for all government credit programmes, implicit contingent liabilities and other fiscal risks, such as those generated by non-budgetary entities, should be at least reported and measured in a statement of fiscal risks (Moretti, Boucher and Giannini, 2021^[4]), as is already done by a number of OECD countries (OECD, 2019^[18]).

Estimating costs of government loans and guarantees

Approaches for measuring the cost of loans and guarantees

There is no one-fits-all approach to estimating costs of loans and guarantees. Standardised loans and guarantees involve a pooling of risks and are very likely to generate cash outflows as it can be expected that in most cases some of the multiple beneficiaries will default on their loan payment or call guarantees. Accordingly, it is often possible to estimate reliably a future average loss by considering historical data. One-off loans or guarantees are, by nature, individual and credit risk analysis also needs to be done on standalone basis, with relatively less certainty on whether losses will be ultimately incurred or not.

In choosing an approach for estimating costs of loans and guarantees over their full lifetime, IPSASs are a useful reference to consider. IPSASs have been revised in 2018 to adopt new “forward-looking” evaluation principles, under which expected credit losses are considered for the initial evaluation of

financial instruments, when they are first recorded in the balance sheet. Therefore, international accounting principles “match” to some extent the recommended approach for budgeting neutrally for loans and guarantees.

IPSAS principles applicable to loans and guarantees (IPSASB, 2023^[19]) can be summarised as follows:

- For loans and guarantees falling under the category “financial instruments”,⁶ IPSASs prescribe mainly recording a liability representing the net present value of expected cash-flows for the scheme, using a so-called “dual measurement approach”.^{7,8} IPSASs also prescribe market discount rates be used for measuring the present value of expected cash flows. The operating statement records the corresponding net benefit or loss. This represents the cost of the scheme for the government and should be treated as expenses in appropriations.
- For a concessionary loan, IPSASs require that the market value of the loan be determined with so-called “day one” losses generated by the concessionary interest rate measured at the time when a loan is granted. The operating statement records these losses. These represent the cost of the concessionary loan for the government and should be treated as expenses in appropriations.
- For guarantees that do not fall under the category “financial instruments”, IPSASs prescribe that a provision should be recorded on the government’s balance sheet if there is a higher than 50% chance that this guarantee will be called. The operating statement records the corresponding loss. This represents the cost of the guarantee for the government and should be treated as an expense in appropriations.

In defining a budgetary treatment for loans and guarantees, governments should avoid to the extent possible discretion and aim for prudence. Therefore, where IPSASs offer options or rely heavily on judgement, countries may want to use simpler and/or more prudent principles for budgeting. For instance, concerning guarantees that are not financial instruments, the accounting treatment prescribed by IPSAS relies heavily on judgement and may understate expected costs: a tail event that is unlikely to occur could still have major budgetary implications. Some countries, such as the United States, have therefore adopted a more prudent budgetary treatment, which consists in reporting the possible effects of “unlikely events” in the budget using an expected value approach that considers the full range of outcomes, irrespective of any “50 percent threshold”.

Steps of recording budgetary appropriations

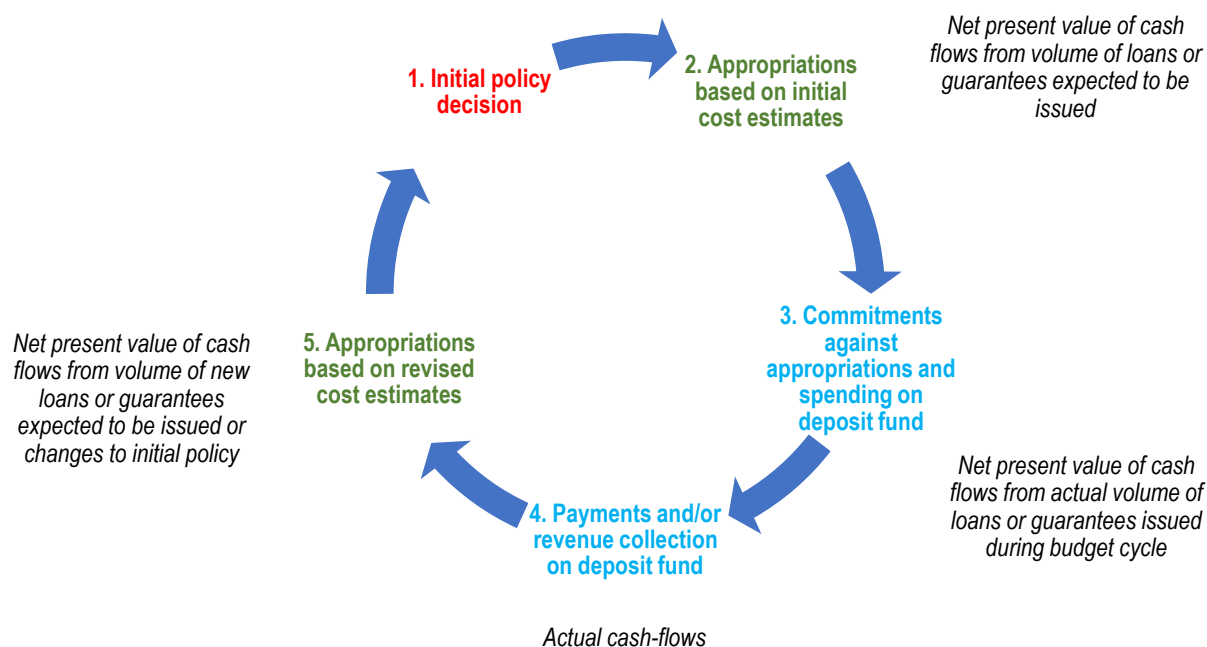
In implementing the measurement approach for standardised loans and guarantees, budgetary entities will be required to estimate all the estimated cash-flows for a given scheme, but also estimate how many loans or guarantees are expected to be granted over relevant budget periods (annual budget and/or medium-term fiscal plan). The appropriation allocated in the budget to the scheme, and resource envelope in the medium-term fiscal plan, will therefore cover costs from the successive cohorts of loans that governments will likely enter during each fiscal year covered by the budget and medium-term fiscal plan.

As part of each budget cycle, budgetary entities will be required to update these estimates, which may imply: i) revising previous estimations of the number of loans and guarantees that will be entered into; ii) revising estimates of likely costs associated with each cohort of loans and guarantees; and iii) adding an outyear to the medium-term fiscal plan if additional obligations are expected to be incurred by government over that period (Figure 2).

The recording of the appropriations for the costs of loans and guarantees should be done on the most appropriate budget line. As the purpose of this budgetary treatment is to allocate resources to cover for the subsidy element of government loans or guarantees, a classification under the “transfer” or “subsidy” chapter of the budget would be justified. This is for instance the approach followed in Sweden, in cases when there is a “substantial subsidy element” in loans or guarantees.

In implementing what can be considered as a complex budgetary treatment, judgement can be applied. For instance, in the case of Switzerland, appropriations are recorded only significant schemes and those that are not considered significant in terms of their gross amount may not be budgeted for. In parallel fashion, in the United States, the Congressional Budget Office (CBO) uses its own subsidy estimates for student loans and the various mortgage finance credits, which are large programmes. For smaller programmes, it uses Office of Management and Budget's estimates.

Figure 2. Steps of appropriating resources for loans and guarantees' costs



Source: Author's elaboration.

Concerning one-off guarantees, it will be often the case that a guarantee will be granted initially on the assumption of a low probability of it being called, but subsequently the financial situation of the beneficiary might be deteriorates to the point where a call on the guarantee seems to be more likely than not. Therefore, budgetary entities should be required to monitor at least annually their portfolio of one-off guarantees to identify any such situation and allocate appropriate resources in their budget envelope to cover corresponding losses.

Methodological issues

In estimating the costs of loans and guarantees, OECD countries experience show that there are key methodological issues with: i) estimating default and calls risks; ii) choosing a discount rate; and iii) integrating administrative costs in estimates of future cash flows. Each one of these factors can significantly influence the outcome of the costing and have an even more significant impact taken all together.

On estimating risks of defaults and calls, a range of approaches are used by OECD countries. For one-off loans and guarantees, credit ratings are most used. For standardised loans and guarantees possible approaches include credit ratings (e.g. Australia, Sweden, and Switzerland), statistical models (e.g. Republic of Türkiye) and stochastic simulations (e.g. Sweden). The choice of an approach is highly context-specific, with "key differentiating factors [including] characteristics of the guarantee and on-lending

portfolio, the sovereign's specific risk exposure, the availability of market information and data, and resources and capacity in the public sector" (Bachmair, 2016^[20]).

On the setting of a public sector discount rate, OECD countries follow a range of approaches. Some OECD countries (e.g. Australia, New Zealand, and Switzerland) use market rates as prescribed by IPSAS. The United States' Office for Management and Budget uses the government's own borrowing rate. The United Kingdom uses "the higher of the rate intrinsic to the financial instrument and the real financial instrument discount rate set by HM Treasury".⁹ The choice of market or government own borrowing rates can have significant impact on the measurement of costs of loans and guarantees. For instance, in the United States, the Congressional Budget Office estimated that for new loans and loan guarantees issued in 2023, depending on the borrowing rate used, the policy would be estimated to carry a significant subsidy cost vs. generating significant savings.¹⁰

Pros and cons of using market or government own borrowing rates have been discussed in several recent publications (Hong and Lucas, 2023^[13]; Anderson and Burke, 2021^[12]). Debates are on-going and can be very briefly summarised as follows:

- The logic of using government own borrowing rates is that government loans and guarantees' costs should be measured based on the actual financing conditions for the government.
- The logic of using market rates is that government loans and guarantees' costs should be determined irrespective of them being financed by government, which benefits from more favourable financing conditions than the private sector due to taxpayers' acting as risk-absorber and therefore implicitly are bearing that cost, even if not measured in the budget. It is to be noted that the use of market rates can convey practical challenges as these rates may not be publicly available, as experienced recently by Switzerland (Walker and Matter, 2023^[21]).

The United States' experience shows that integrating or not administrative resource requirements – that is the costs to manage a loan or guarantee programme (including salaries of staff) - can have substantial impact on the estimated subsidy cost for loans and guarantees programmes, and therefore influence decision making on most appropriate financing model for a policy (Anderson and Burke, 2021^[12]). Therefore, it is required that "an examination of the agency's current capacity to administer the new or expanded programme and an estimation of any additional resources that would be needed, and an explicit estimate of the expected annual administrative costs including extension, servicing, collection, and management and oversight functions" is required for any credit programme (Executive office of the President Office of Management and Budget, 2013^[6]).

Integrating administrative expenses in the costing of loans and guarantees schemes is necessary to inform decision makers on the full cost of these programmes, but is not consistent the objective of creating a level playing field with direct spending as grants, transfers and benefits-related appropriations does not include administrative costs. Therefore, countries may consider providing activity-based costings for loans and guarantees that include administrative costs, programmes in the budget documentation but recording allocating resources in appropriations that do not include administrative costs.¹¹ In such a case, budget instructions should require that administration costs of these schemes be properly accounted for in baselines provided by budgetary entities as part of the budget formulation process.

Data challenges

Reliable estimation of costs associated with government loans and guarantees does not require only a sound measurement approach but also appropriate data to implement the methodology. Tellingly, at the outset of the COVID-19 pandemic, many OECD countries only disclosed in their budget documentation a figure on the maximum exposure on loans and guarantee schemes announced by governments, with the lack of historical data on new and emergency schemes announced by governments often cited as the main cause for not providing cost estimates (Moretti, Braendle and Leroy, 2021^[2]). Irrespective of constraints

experienced during crisis situations, assembling data necessary to produce costs estimates is generally considered a challenging exercise (HM Treasury, 2020^[8]).

In implementing budgeting for loans and guarantees, a key task for governments is therefore to establish procedures in budgetary entities to ensure that relevant data on loans and guarantees administration are, first, collected and, second, properly maintained. In the case of the United States, data collected includes, among other things, historical data and trends, sensitivity analysis or actuarial analysis that identifies the critical factors in predicting cashflows, reports from accounting systems, documentation of programme design factors relevant to the estimates including defined fees, grace periods, terms to maturity, borrower interest rates, legal definitions, and programme eligibility requirements (Anderson and Burke, 2021^[12]).

In the case of new schemes with no historical data available, budgetary entities should be encouraged to: i) use alternative data sources assuming these are considered reliable enough; and ii) apply their best judgement in defining which external data sets or expert opinion to use. For instance, in 2020, Switzerland provided a new type of guarantee on more than 100 000 commercial bank loans as part of their response to the COVID-19 crisis and used external rating agencies' credit rating as an input to assess the average probability of default and record the corresponding liability on the government balance sheet (Walker and Matter, 2023^[21]).

Budgeting for loans and guarantees in cash budget systems

As noted above, appropriations are managed on cash-basis in the vast majority of OECD countries. This reflects the fact that cash appropriations allow more reliable and understandable setting of spending limits and better control over actual resources spent by ministries and departments, contrary to accruals-basis, which may generate volatility and discretion in spending limits estimates. Some countries have however moved away from "strict" cash-basis by introducing some accruals concepts where these were supporting better budgetary decision making.

In budgeting for loans and guarantees on accruals basis in an otherwise cash-basis appropriations system, the successful experiences of the United States and Sweden in using notional reserve accounts for budgeting for standardised loans or guarantees programmes are noteworthy:

- In the United States, a system of "financing accounts" is used. The financing accounts are included in the budget totals but are treated as a "means of financing", defined by OMB as "...monies received or paid by the Government that are not counted in the budget totals as either collections (governmental receipts, offsetting collections, or offsetting receipts) or outgo (outlays)" (Anderson and Burke, 2021^[12]). For loans, financing account include: i) appropriations (called "subsidy payment"); ii) borrowing from Treasury to finance the loans; and iii) actual cash flows from the loans (loan disbursements, default payments to lenders, loan repayments, interest payments, recoveries on defaulted loans, and fee collections). The financing account is used to repay Treasury with interest over time, using payments from the borrower. For guarantees, financing accounts hold: i) appropriations, which serve as a reserve against default claims; ii) interest earnings on this reserve from Treasury and; iii) and actual cash flows from default claims. This system also allows make sure the costs estimates and cash-flows line up.
- In Sweden, each responsible authority keeps a "notional reserve account" at the Swedish National Debt Office. Expected losses from lending and guarantees are credited to the notional reserve account. A call on state guarantee is booked against the applicable nominal reserve and the resulting payment is charged against the Treasury Single Account. Fees and recoveries are also recorded in these nominal accounts and transferred into the central government revenues to decrease the SNDO's borrowing requirement.

The United Kingdom's approach to budgeting for one-off guarantees is also noteworthy. government policy mandates that when departments decide to enter into a new one-off guarantee, this guarantee must be affordable within their existing resource budgets, unless there is a bespoke agreement that extra resource will be provided (HM Treasury, 2017^[22]). Therefore, expected losses are recorded as “non-cash costs” in the appropriations, under the category “annually managed expenditures”. This gives departments approval to spend, but do not entail a cash allocation, so if the guarantee crystallises, it is expected that resources will be reallocated from another budget line or from the contingency reserve managed centrally by the Treasury.

Role for Budget Offices

Roles and responsibilities for the management of government loans and guarantees have been an area of attention since the global financial crisis, during which governments started making significant use of these mechanisms to support banks and corporations through the crisis. At that time, a more active engagement in the management of contingent liabilities of a number of stakeholders was called, including budget offices and debt management offices. Using debt management office's expertise in areas such as producing guarantees issuance guidelines, estimating premiums to be charged on guarantees, managing of guarantees-related reserve funds was for instance highlighted as essential (Ülgentürk, 2017^[23]). Budget offices were expected to take a more active role in budgeting for loans and guarantees, along the two main lines discussed below.

First, they should play a role in highlighting budgetary issues with non-standard policy instruments such as loans and guarantees to the attention of policymakers. They should also take the lead in proposing new or improved approaches for budgeting for loans and guarantees, consistent with the principles stated in section 2 above. In doing so, budget offices fulfil their key role of achieving allocative efficiency.

Second, they have a crucial role to play in operationalising this approach as part of their role of co-ordination of the budgets and appropriations' formulation for completeness and accuracy. This involves at least:

- Defining rules and principles regarding data collection on loans and guarantees by budgetary entities, including which type of data to collect, time-periods to be covered, auditability requirements, etc.
- Defining requirements for all new policy proposals involving a guarantee or loan, including the production of an estimate of the full cost of the new policy as well as quantification of costs of delivering the same policy objectives through traditional financing.
- Providing methodological guidance on how to assess the costs of loans and guarantees, including designing appropriate calculation tools and updating these at least annually (e.g. with up-to-date discount rates).
- Reviewing new policy proposals, including assessing the clarity of the stated objectives, verifying costings, the soundness of criteria and rules for granting loans and guarantees, etc.
- Requesting that budgetary entities' multi-year baselines and annual budget submissions include costs for government and loans, as well as any increase in administrative, including legal, costs for the administration of these programmes, which as noted above may be consequential.

Another important role for ministries of finance is to manage movements from or to any actual or notional deposit fund – that is recording and monitoring cash outflows (loan disbursements, pay-outs for guarantees, etc.) and cash inflows (reimbursements, interests, fees, etc.). This might be a function of the budget office or, alternatively, of the Treasury function within the ministry of finance.

An important decision to make in defining operational procedures for budgeting for loans and guarantees is whether to decentralise or centralise the measurement of their costs. Centralisation and decentralisation have pros and cons. Budgetary entities have first-hand knowledge of schemes and programmes, but the budget office and a few specialised entities have most of the technical knowledge required for producing the costings, such as credit risks analysis for credit programmes, actuarial analysis for insurance programmes, as well as general commercial and legal expertise,

If the decentralisation approach is favoured, the budget office should ensure that budgetary entities are provided with all necessary guidance. In the case of Australia, for instance, the Department of Finance supports agencies through a team assigned with specific sectors and tools and guidance available on the department's website. In the case of the United States, however, fragmented responsibilities are considered by some commentators to have caused inefficiencies (Anderson and Burke, 2021^[12]).

In any case, establishing a strong central capacity to directly produce costings or verify the costings produced by budgetary entities is generally considered a key success factor in managing risks associated with loans and guarantees (HM Treasury, 2020^[8]). Such a central capability should be in the budget office with the responsibility of co-ordinating with relevant specialised entities for expert knowledge or data, such as the debt management office and agencies specialised in credit or insurance programmes management.

Conclusion

This paper asked whether “budgeting can catch up with the rise of non-standard policy instruments”, and more specifically with the rise of loans and guarantees. The answer is clearly yes based on the experiences of the OECD countries presented in this paper. Budget systems however still need to adapt to this new paradigm in most OECD countries.

Key considerations for successfully managing non-standard policy instruments include:

- Budget offices should have a leading role in proposing budgetary treatment for loans and guarantees that ensure an even-level playing field with traditional spending (i.e. budget neutrality) and put considerations of efficiency of spending above optimisation of short-term fiscal outcomes.
- Loans and guarantees used to fund government policies directly should be explained in legislation and/or budget documentation and the budgetary treatment applicable to each category defined. Any exception to the principle of budget neutrality should be identified and explained.
- For achieving budget neutrality, costs of standardised loans and guarantees should be measured based on estimates of the net present value of all expected cash-flows from them. In defining a measurement method, IPSASs can be used as reference and clarity is needed on approaches for evaluating risks of defaults and calls; discount rates to be used; and inclusion or not of administrative costs in costs evaluations.
- For one-off loans and guarantees, budgetary treatments should be prudent and avoid relying too heavily on discretion and judgement. Countries may consider the United States approach of recording possible effects of “unlikely events” in the budget using an expected value approach.
- When losses incurred from loans or guarantees are recorded on accrual-basis in an otherwise cash-basis appropriations system, an actual or notional deposit accounts should be used to record these accrual expenses separately from actual cash-flows.
- Data requirements for measuring costs of loans and guarantees should be specified in Budget Offices' instructions to budgetary entities, with options and alternatives offered in case when historical data is lacking.

- Budget offices should establish a strong central capability with relevant expertise for producing directly or verifying costings of loans and guarantees and co-ordinating with agencies with specialised knowledge.
- Government loans and guarantees provided by non-budgetary entities should be monitored and measured as part of the government's fiscal risks management framework. Such monitoring should allow tracking the actual costs of these programmes.

Improvements to budgeting practices is a fundamental piece of the puzzle for strengthening fiscal management of loans and guarantees and other non-standard policy instruments. As highlighted by recent discussions of the SBO, another key consideration is in relation to consistency in how loans and guarantees are treated within the fiscal framework. Specifically:

- The budgetary and accounting treatment for loans and guarantees – i.e. appropriations, once executed, should be reported as expenses in a timely and comprehensive manner; and
- The fiscal rules used by the government – for instance, in the case of Switzerland, the fiscal rule is a so-called “debt brake”, which is in nature an expenditure rule. Expenses considered to calculate the debt brake include provisions and other valuation changes in relation to loans and guarantees, and other types of liabilities (Schuler, Presentation for Switzerland at the 2023 meeting of OECD Senior Budget Officials^[24]).

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Notes

¹ Spending limits are presented on cash and/or commitment bases by 16 countries, on both cash (or commitment) and accrual bases by 10 countries and on accrual basis by only 6 countries (OECD, 2019^[18]).

² In the United States, concerns with budgeting practices for credit programmes began to surface in the early 1980s. The two innovative approaches considered to improving budgeting for credit programmes at the time are presented in a Congressional Budget Office study, called *New Approaches to the Budgetary Treatment of Federal Credit Assistance* (Congressional Budget Office, 1984^[25]). One of the approaches envisioned at the time was federal credit and budget accounting policies would remain unchanged, but the federal government would adopt the practice of a) selling all new direct loans and b) purchasing reinsurance from non-federal insurers for all new guarantees issued. The loss on the origination and sale of loans and on the issue and purchase of equivalent insurance would provide the government with a cash-basis, opportunity cost that would appear in budget outlays and the deficit without the necessity of further change. This also solved the practical “problems” associated with other non-market solutions of estimating costs, identifying appropriate market discount rates, and settling the treatment of origination and servicing in the cost estimate.

³ These documents are all part of ongoing efforts by the Committee of Senior Budget Officials (SBO) to define features that constitute quality budget institutions and identify good practices that can support their effective implementation in OECD countries.

⁴ Direct loans are a disbursement of funds by the government to a non-Federal borrower under a loan agreement that requires repayment with or without interest. Loan guarantees include any guarantee, insurance, or other pledge of payment any portion of principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender.

⁵ Rationale for excluding deposit insurance programmes from the Credit Reform Act includes the fact that the goal of these programmes is to maintain stability and public confidence in the US financial system, which is monetary policy rather than fiscal policy.

⁶ Financial instruments are defined in international accounting standards as contracts that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

⁷ For loans, these cash flows may include initial disbursements, repayments of principal and payments of interest and fees, estimated defaults, payments of penalties and other payments to the Government over the life of the loan, and recoveries or proceeds of asset sales in case of default, etc. For guarantees, these cash-flows may include payments of premiums, estimated calls, revenues from collaterals, etc.

⁸ The dual measurement approach authorises to estimate expected losses from financial instruments over 12-months or their lifetime. The determination of which expected losses to consider depends on whether there has been a significant increase in credit risk since the inception of the financial instrument: if there has not been a significant increase (typically the “normal” scenario), only the 12-month expected credit losses are factored into the loss allowance for the instrument; and if there had been a significant increase, the loss allowance needs to consider the lifetime expected credit losses of the instrument (which is often a higher amount than its 12-month expected losses). Whether a significant increase in credit risk has occurred depends on an assessment of any changes to the probability of default over the life of the instrument, and not changes to the expected loss itself.

⁹ The real financial instrument discount rate set by HM Treasury is recalculated annually and is made up of two components. Firstly, the nominal rate is based on yields on UK government bonds as published by the Bank of England. Secondly, the rate of inflation, which in practise may be retail prices index (RPI) or consumer prices index (CPI) or perhaps a similar rate depending on the individual loan or guarantee. The Office of Budget Responsibility produce a forecast for various inflation rates biannually as part of their Economic and Fiscal Outlook publication that is used for the purpose of defining the rate of inflation when calculating a real discount rate.

¹⁰ “Using Federal Credit Reform Act of 1990 procedures, the Congressional Budget Office (CBO) estimates that new loans and loan guarantees issued in 2023 would result in savings of USD 41.1 billion. But using the fair-value approach [which measure the market value of the government’s obligations], CBO estimates that those loans and guarantees would have a lifetime cost of USD 51.1 billion.” See <https://www.cbo.gov/publication/58031>.

¹¹ Activity based costing identifies and assigns the cost of each activity or specific input that delivers a service or output.

Medium-term and top-down budgeting in OECD countries

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This paper, based on preliminary results of the 2023 OECD SBO Survey on Budget Frameworks, takes stock of OECD countries' practices in top-down and medium-term budgeting. It shows that OECD countries' fiscal frameworks can be characterised by strong reliance on multiple fiscal rules or objectives for enforcing fiscal discipline, with medium-term and top-down budgeting not used yet to their full potential in some countries. Drawing on the OECD Spending Better Framework, this paper advises that countries that wish to strengthen their fiscal frameworks reinforce the processes and institutions that underpin effective medium-term and top-down budgeting systems. Central to this is producing and publishing more regularly baseline projections of government expenditures and setting credible multi-year expenditure ceilings that serve as stringent guidelines for budget planning, while also allowing for some degree of flexibility under clearly defined conditions.

JEL classification: H61

Keywords: medium-term budgeting, top-down budgeting, fiscal framework, fiscal rule, MTEF, baselines, expenditure ceilings.

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Introduction

What are Top-Down and Medium-Term Budgeting

In the wake of the COVID-19 pandemic, Russia's war of aggression against Ukraine and the related energy crisis, most OECD countries are grappling with elevated debt levels and high deficits. This is coupled with short to long-term spending pressures from factors such as ageing and the climate transition (OECD, 2023^[1]). The requirement of both putting public finances back on a sustainable path while spending more in new and vital areas calls for budget frameworks that not only support fiscal consolidation but also “ensure that resources are allocated where they are most valued and away from areas where they are less valued” as encapsulated in the OECD Spending Better Framework (OECD, 2023^[2]).

The OECD Spending Better Framework is organised around ten principles defining core entities, functions, processes, and procedures for quality budget institutions. The first four principles of the OECD Spending Better Framework refer to the setting of fiscal objectives, production of medium-term fiscal forecasts based on objective economic assumptions, preparation of multi-year expenditure baselines (referred to as “baselines” hereinafter) and adoption of top-down expenditure ceilings (referred to as “expenditure ceilings” hereinafter) (Figure 3).

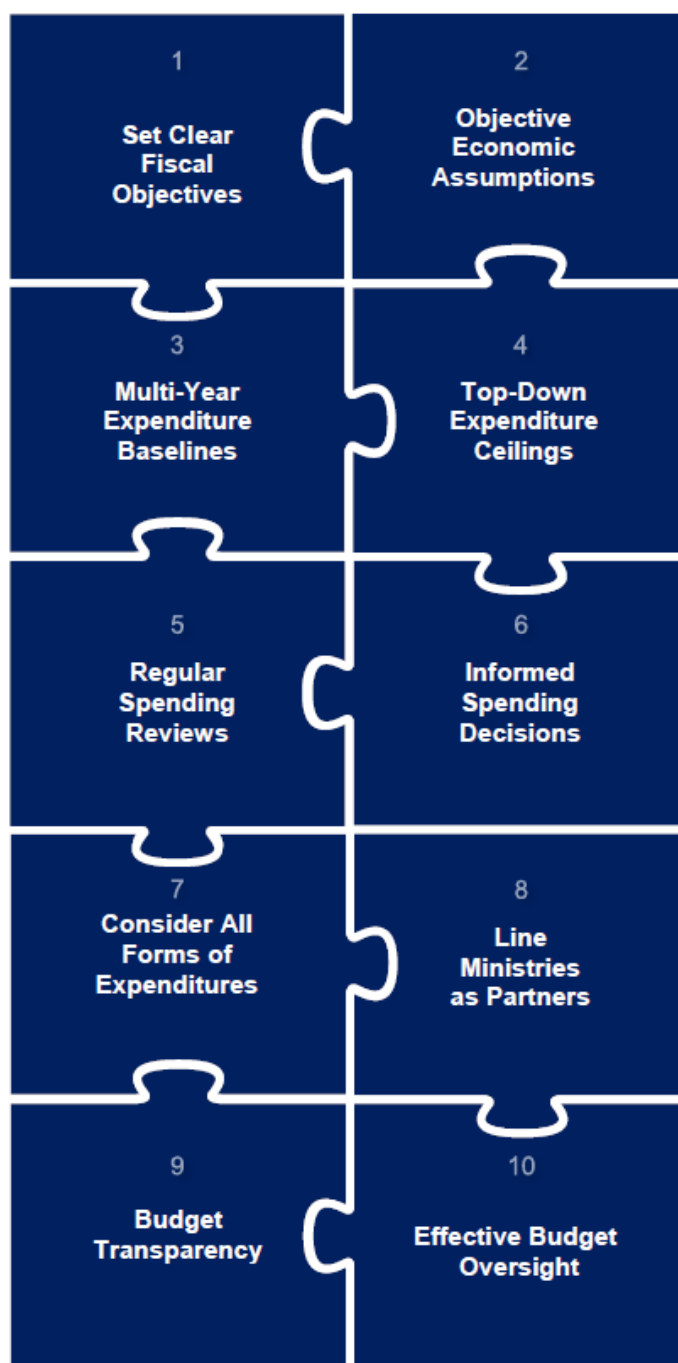
These four principles relate to the concept of medium-term and top-down and budgeting, defined as the actions of:

- Budgeting for multiple years (usually 3-5 years), as opposed to focusing solely on the upcoming fiscal year.
- Defining spending limits based on the economic forecast, estimates of future spending on current policies (the baselines) and the government's fiscal objectives, before considering bottom-up budget requests.

The benefits of medium-term and top-down budgeting are well known. Medium-term budgeting is designed to bring a longer-term perspective to the budget process, both helping policymakers to consider the future fiscal implications of immediate policy decisions and providing greater predictability on future availability and allocation of resources. The top-down approach is aimed at maintaining fiscal discipline and ensuring that budgeting is aligned with the government's fiscal strategy and policy priorities. Both of these budgeting approaches are therefore advocated in the OECD *Recommendation of the Council on Budgetary Governance* (OECD, 2015^[3]).

Medium-term and top-down budgeting are different concepts, but they should be implemented concurrently. This is because the setting of expenditure ceilings is a budget decision that can be done only when fiscal constraints from fiscal objectives and economic forecasts, as well as bottom-up pressures evidenced by multi-year baselines at the most granular level, are identified and analysed. In other words, the role of expenditure ceilings is not to put arbitrary and unmanageable constraints on budget preparation, but rather to ensure that no overspending takes place once all constraints have been identified and acted upon, including through tax policy.

Figure 3. Top-down and medium-term budgeting principles in OECD Spending Better Framework



Note: Principles relating to top-down and medium-term budgeting are highlighted in blue.

Source: (OECD, 2023^[2])

The paradox with top-down and medium-term budgeting

Top-down and medium-term budgeting are well-established concepts. They are, in fact, among the most popular feature of budget systems in OECD countries. These budgeting approaches were used by just a half of OECD countries in 2007 and are now used by a large majority of them as the result of a decade of budget reforms in the wake of the global financial crisis (Figure 4).

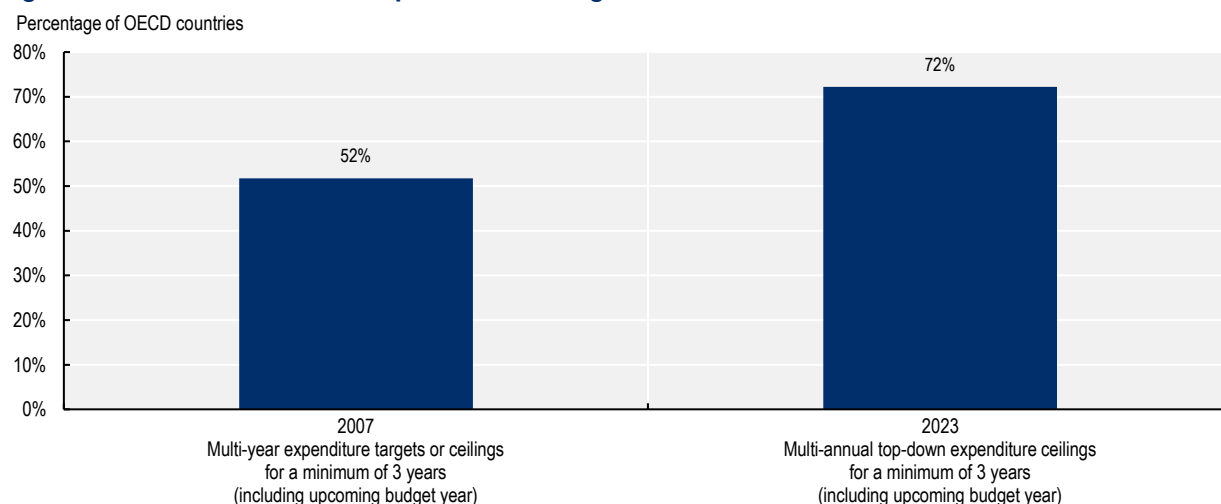
Accordingly, OECD countries are considered as both pioneers and leaders in in this area. Medium-term expenditure frameworks (MTEFs) are the typical outcome of top-down and medium-term budgeting processes. A 2012 World Bank study identified for instance OECD countries as the group for which MTEFs have had most perceptible effects on improving fiscal outcomes, in particular for those countries that use the most advanced form of MTEFs as per World Bank's classification (World Bank, 2012^[4]).²

This raises the question: is there anything left to say on top-down and medium-term budgeting concerning OECD countries? The fundamental paradox with these approaches to budgeting, which is that their popularity also comes with substantial criticism of their effectiveness, suggests so.

Indeed, recent OECD budget reviews, reports by OECD countries' budget oversight bodies and academic studies mention persisting challenges in designing and implementing effective top-down and medium-term budgeting processes, evidenced by recurring and sometimes significant divergences between stated fiscal objectives, expenditure ceilings and actual spending. For instance, a recent audit offices' report mentioned difficulties in determining whether medium-term budgets in seven European Union countries were "directing the level of expenditure or reacting to it" (Contact Committee Fiscal Policy Audit Network, 2022^[5]).

Preliminary results of the 2023 OECD SBO Survey on Budget Frameworks (referred to as "the 2023 SBO survey" hereinafter) reinforce this perception. To the question "is the most recent approved budget consistent with the multi-annual top-down expenditure ceilings set in the previous year?" only a minority of OECD countries answered positively (Figure 7), as further discussed in Section "Effectiveness of expenditure ceilings". Therefore, as summed up by Allen Schick already more than a decade ago, top-down and medium-term budgeting seem to remain "at once among the most popular contemporary [budgetary] innovations and among the most misapplied" (Schick, 2009^[6]).

Further, the debate over what constitutes "good" medium-term and top-down budgeting is somehow unsettled. On the one hand, considerable academic literature has analysed possible features for MTEFs - their legal basis, their duration, their binding or indicative nature, the granularity of expenditure ceilings, etc. - without identifying any clear link between a given approach and improved outcomes on enforcing fiscal discipline and improving allocative efficiency. On the other hand, the context in which MTEFs are implemented has been recognised as deeply affecting their effectiveness. For instance, a recent study identified political and administrative cultures as primary factors in using successfully or unsuccessfully MTEFs (Raudla, Douglas and MacCarthaigh, 2022^[7]).

Figure 4. Use of multi-annual expenditure ceilings and/or MTEFs in OECD countries, 2007-2023

Note: Data for Lithuania and Mexico are not available in 2023.

Source: OECD (2007), OECD Budget Practices and Procedures Survey, results for 29 countries; OECD (2023), OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q16.

While underscoring the significance of political and administrative cultures in the success of MTEFs is essential, doing so can also instil a sense of powerlessness in budget offices. Over time, this may erode the credibility of top-down and medium-term budgeting approaches. To mitigate this risk, it is advisable that research re-focus on the requisite functions, processes, and procedures to support effective top-down and medium-term budgeting. Although these measures may not directly confront the political and administrative behaviours that have hindered past implementations, they serve as safeguards that can gradually foster behavioural change.

Against this background, this discussion paper uses the preliminary results of the 2023 SBO survey to present key findings on OECD countries' practices in each of the four principles of the OECD Spending Better Framework most directly associated with top-down and medium-term budgeting. It focuses on functions, processes, and procedures underpinning top-down and medium-term budgeting. It is structured as follows: Section on "Fiscal objectives and economic assumptions" discusses findings of the 2023 SBO survey on use of fiscal objectives and approaches to avoiding bias in economic assumptions, which are both serving as the foundation for top-down and medium-term budgeting. Sections on "Baselines" and on "Expenditure ceilings" discuss respectively the use of baselines and practices with expenditure ceilings. Section on "Conclusions and policy recommendations" concludes this paper with policy recommendations for strengthening top-down and medium-term budgeting approaches.

Fiscal objectives and economic assumptions

What are fiscal rules and fiscal objectives

Countries need to operate their public finances according to a clear strategy that the government is committed to, embodied in fiscal rules or fiscal objectives. In the 2023 SBO Survey, fiscal rules are defined as numerical parameters set in legislation to put a long-lasting constraint on budgetary aggregates. Fiscal objectives differ from fiscal rules only in that they are not legally binding but politically mandated (e.g. in a government statement to parliament). Academic studies emphasise that while a robust legal foundation enhances the durability and credibility of fiscal rules, the key determinant of a fiscal strategy's success lies in its effective implementation rather than its legal underpinning (Davoodi et al., 2022^[8]). The extent to which these politically mandated targets align with the definition of fiscal objectives – i.e. a long-lasting

constraint on budget aggregates – requires retrospective evaluation, including an assessment of whether targets have been adjusted by the government in response to changes in the fiscal outlook.

Fiscal rules and objectives can have different purposes and target different budget aggregates. The purpose of a fiscal rule or objective may be to provide either a long-term anchor for public finances or shorter-term budget targets, with the latter aimed at operationalising the former. Budget aggregates that are targeted are traditionally the budget balance (or deficit/surplus), debt, expenditures or revenues. Although appropriate fiscal rules or objectives for a given country need to be appreciated on a case-by-case basis, recent research has highlighted that a prudent long-term debt anchor serving as a reference point for defining numerical budget balance or expenditure rules or objectives to be complied with in the annual budget process suits most countries well (Fall et al., 2015^[9]).

2023 SBO Survey's findings

Types of fiscal rules

Consistent with trends observable prior to the pandemic (OECD, 2019^[10]), the 2023 SBO Survey shows that all 36 respondents set national fiscal rules or fiscal objectives. Specifically, the majority of respondents (19 countries) operate with both fiscal rules and fiscal objectives; a large group of respondents (12 countries) use only fiscal rules set in Constitution or legislation; and a smaller group of respondents (5 countries) use only politically mandated fiscal objectives. The setting of politically mandated fiscal objectives is sometimes a legal requirement. That is the case, for instance, in New Zealand.

Also consistent with prior-pandemic trends, the 2023 SBO survey's preliminary results show that most OECD countries use multiple fiscal rules and objectives – that is, on average, more than 6 fiscal rules or objectives. In this respect, it is notable that, within the group of countries that operate with Constitutional and legislated fiscal rules, a significant group (9 countries) set additional fiscal goals in regulations or other such documents.

Typically, countries with a budget balance objective may set both nominal and structural numerical targets (18 countries) and there might be separate expenditure rules constraining different spending areas (15 countries). Reasons for this include legacy effects (as economic and fiscal conditions change, new rules may be added to address emerging concerns without necessarily removing existing ones) and the choice by several countries to rely primarily on a rules-based approach to constrain spending decisions. In member states of the European Union, the simultaneous presence of national fiscal policies and the regulations stipulated by EU Treaties leads to the existence of multiple fiscal targets.

If fiscal rules and objectives are analysed individually, budget balance rules are the type of rule that is most used across OECD countries, followed by debt rules (Figure 5, Panel A). However, a more insightful examination is to look at what type of combination are most used (Figure 5, Panel B): more than a third of respondents use a debt rule operationalised by budget balance, expenditure and revenue rules and close to a third of respondents use a combination of debt, budget balance and expenditure rules.

Other combinations are less prevalent. It is noteworthy that New Zealand is the only country that uses a net worth-based fiscal objective. In addition, in the United Kingdom, although the government does not target one specific balance sheet metric, it aims to “strengthen over time a range of measures of the public sector balance sheet such as public sector net debt, public sector net financial liabilities and public sector net worth”.³

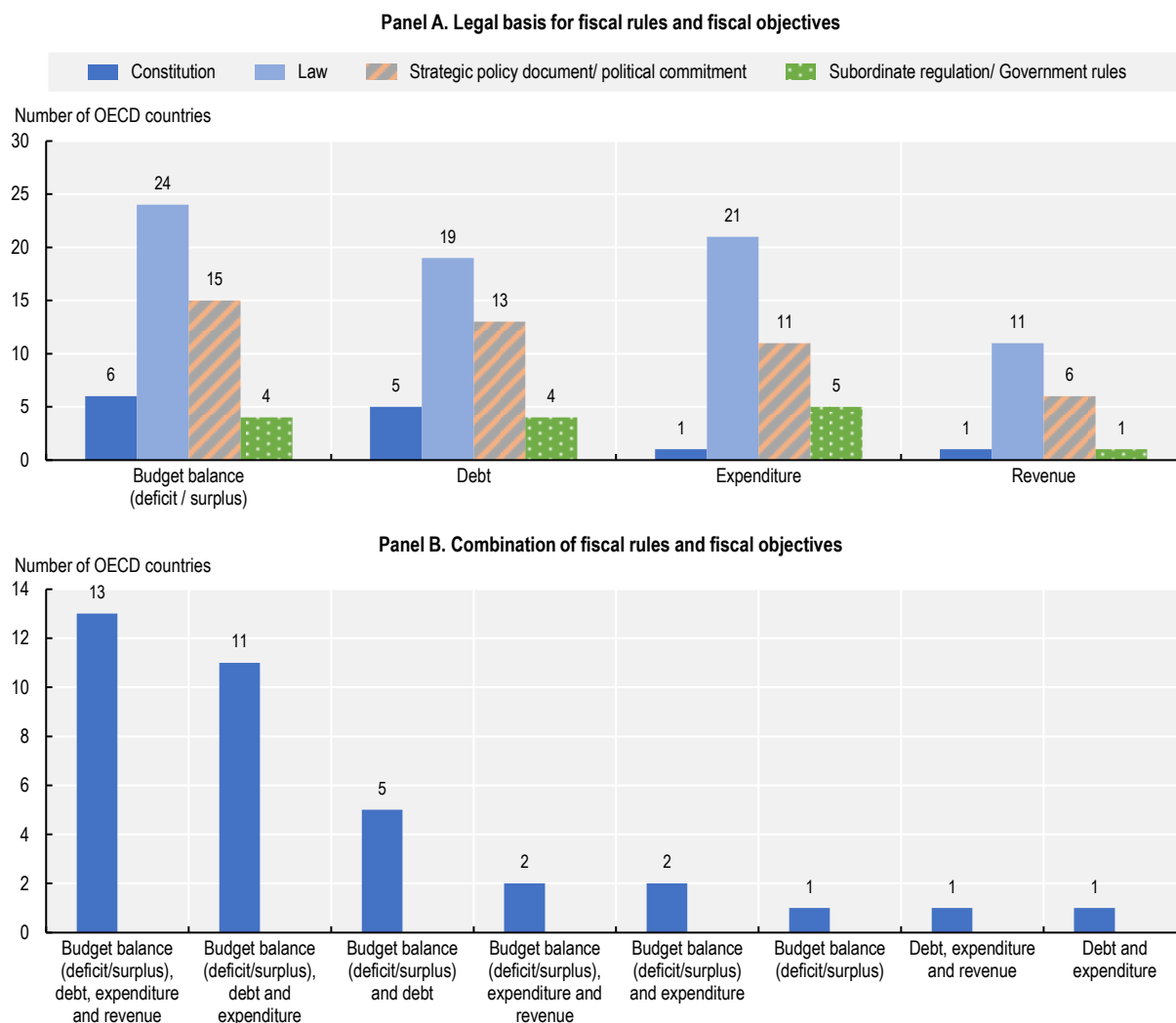
Additionally, it's worth noting that fiscal goals are not always expressed through precise numerical benchmarks. For instance, Australia's federal fiscal strategy outlines objectives such as stabilising and subsequently decreasing both gross and net debt relative to the size of the economy, as well as managing the rate of expenditure growth.

Enforcement and flexibility mechanisms

Concerning enforcement of fiscal rules and objectives, a small group of 7 countries do not have any mechanism in place. However, within this group of countries, 4 countries indicated that governments have a proven record of strong political commitment and implementation of corrective measures. Other countries use systems of automatic correction (12 countries), require that the government provide reasons for deviations (12 countries) and/or propose corrective actions to the legislature (12 countries).⁴ Only 6 countries use a system of automatic sanction.

Concerning flexibility, most respondents to the 2023 SBO Survey that have quasi-permanent fiscal rules grounded in Constitutions or primary legislation have also embedded escape clauses in the legal framework (19 countries). Escape clauses also exist in some countries where fiscal objectives are politically mandated (e.g. United Kingdom). In addition, flexibility may be embedded in the fiscal rules themselves. For instance, around two-third of respondents use a cyclically adjusted budget balance objective that account for the economic cycle (24 countries).⁵

Figure 5. Fiscal rules and fiscal objectives used in OECD countries, 2023



Note: in the 2023 SBO Survey, fiscal rules are defined as numerical parameters set by the government to permanently or quasi-permanently constrain budgetary aggregates, usually based in legislation. Fiscal objectives differ from fiscal rules only in that they are not legally binding but mandated through political decision (e.g. a government statement to parliament, or a coalition or other political agreement). Other fiscal rules and objectives are not shown in the figures but include (i) the preservation of budget frameworks in case of negative changes in the original revenue and expenditure forecasts, if the budget is approved significant time before the beginning of the budget year (law), (ii) the specification of the public sector net worth (law) and (iii) specific rules for the Government Pension Fund (strategic policy document/political commitment). Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q3.

Fiscal rules and objectives after the COVID-19 pandemic

When public spending soared in OECD countries during the COVID-19 pandemic, most countries made use of the escape clauses embedded in their framework (23 countries). Where such escape clauses did not exist (or did not apply to all fiscal rules), governments resorted to ad hoc suspensions of their fiscal objectives (9 countries). For most OECD countries, in the wake of the pandemic, fiscal rules and objectives need to be credibly reinstated.

In doing so, nearly half of respondents (17 countries) have chosen to modify their pre-pandemic fiscal rules or objectives, while the other half (19 countries) have so far stayed the course with them. However, within the second group, reforms could be implemented within the short to medium term. A point in case is the European Commission's proposal, at the end of October 2022, to reform the European Union's Stability and Growth Pact, which would change supra-national fiscal rules for some OECD countries and could trigger changes to national rules too.⁶

The depth of and rationale for fiscal frameworks' revisions, actual or planned, vary across countries:

- In some countries, numerical targets set for certain fiscal rules or objectives have been recalibrated to account for a new macroeconomic and fiscal situation. For instance, in Denmark, a legislative change has allowed a structural deficit of maximum 1% of GDP, up from the previous ceiling of 0.5% of GDP.
- In other countries, more substantial revisions to fiscal policy frameworks are undertaken or considered. For instance, in Korea, the government renewed its proposal to embed fiscal rules in legislation along with flexibility measures.
- Finally, challenges with the use of multiple fiscal rules or objectives, which include a lack of clarity vis a vis citizens that feed into the wider issue of trust in governments (OECD, 2022^[11]), as well as difficulties in monitoring compliance and enforcing accountability (Davoodi et al., 2022^[8]), are also being considered in revising fiscal frameworks. This was the case for instance during discussions on potential reforms to the European Union's Stability and Growth Pact.

What are economic assumptions

Economic assumptions (e.g. future GDP growth, inflation rates or demographic changes among other variables) are the foundational conditions for developing macroeconomic forecasts. In turn, these macroeconomic forecasts are the bedrock of fiscal forecasts, because the economy's cyclical position drives tax collection and expenditure developments. In the context of top-down and medium-term budgeting, getting economic assumptions right, including ensuring that they are unbiased, is therefore a prerequisite for producing realistic revenue forecast and expenditure baseline, and assessing accordingly future fiscal space or gap against fiscal objectives.

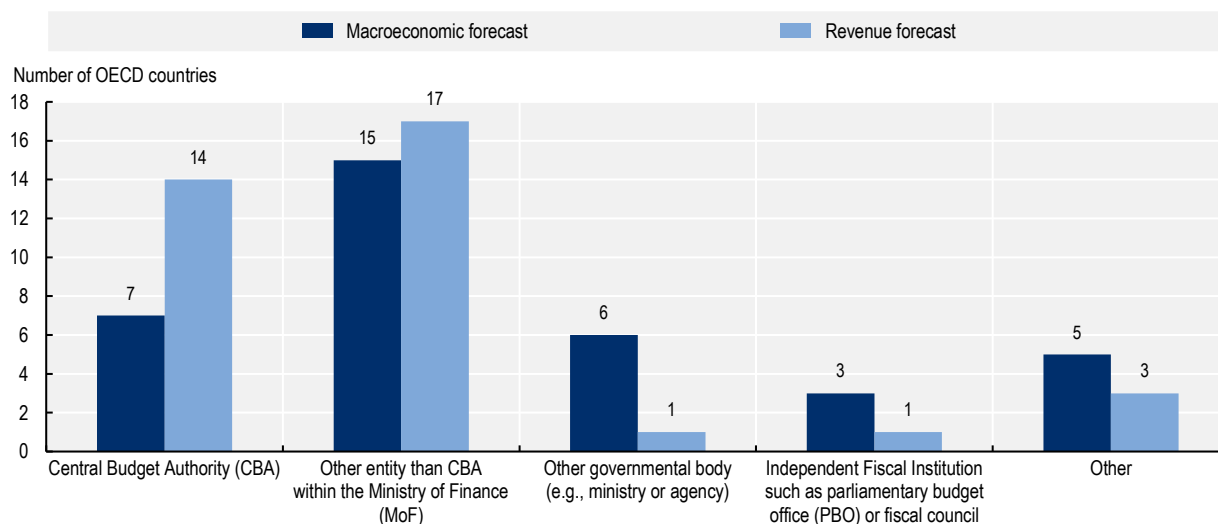
To cement the credibility of their medium-term macroeconomic and revenue forecasts, ministries of finance can use a range of approaches detailed in the OECD Spending Better Framework, which include transparency on key economic assumptions underpinning the forecasts, quantification of how fiscal outcomes might differ from baseline forecasts because of different macroeconomic assumptions and relying on independent fiscal institutions (IFIs), etc.

2023 SBO Survey's findings

Credibility of government forecasts

In a very large majority of OECD countries, macroeconomic and revenue forecasts are prepared by the ministry of finance, either by the central budget authority or another entity within the ministry of finance (Figure 6). In the few countries where this responsibility is not with the ministry of finance, forecasts may be prepared by independent research institutes, working parties with experts from different institutions or the central bank.

Figure 6. Entities responsible for developing forecasts, 2023



Note: Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q6.

For cementing the credibility of the government forecasts, transparency is considered paramount in OECD countries: most respondents publish their forecast in the budget documentation, as well as disclose assumptions underpinning these forecasts and analyse related risks (Table 1). In addition, a large group of respondents rely also on *ex post* analysis of forecast accuracy and require that forecasters follow best professional standards. Other approaches, such as the requirement to take account of forecasts produced by other institutions, are however less used. It is notable that, in Germany, “consensus revenue forecasts” are provided twice a year by the independent working party “tax revenue forecasts”, which consists of experts from different institutions (federal ministry of finance, federal ministry for economic affairs and climate action, central bank (Bundesbank), statistical office, council of economic advisors, 5 research institutes, the finance ministries of the 16 “Länder” and the Federation of German Local Authority Associations.).

Table 1. Approaches to prevent forecasting bias, 2023

	Macroeconomic forecast	Revenue forecast
Forecasts are publicly disclosed in the budget documentation	33	34
Risks to the forecasts are discussed and/or quantified	32	22
Variables, components, and assumptions for the forecasts are disclosed in the budget documentation	27	23
Differences between successive versions of the forecasts are quantified and explained	25	25
Formal role for independent body, e.g. independent fiscal institution (IFI)	25	23

Requirement that forecasters commit formally to follow international/best professional standards	13	12
Institution producing the forecasts required to take account of forecasts produced by other institutions	10	8
Other	2	1

Note: Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO survey on Budget Frameworks, preliminary results for 36 countries, Q7.

The role of IFIs

Independent input into the forecasting process can help bolster its credibility. Accordingly, independent fiscal institutions (IFIs) across OECD countries are often involved in the forecasting process in some way.⁷ For macroeconomic forecasts, the most frequent mandates are:

- Endorsing the government forecasts (11 countries out of 29 countries with IFIs) or assessing its reasonableness (16 countries).
- Publishing an *ex post* evaluation of its accuracy (15 countries).
- Publishing an alternative forecast (9 countries) (OECD, 2021^[12]).

In a small number of cases, the IFI is mandated to prepare the macroeconomic or revenue forecast itself (3 countries and 1 country respectively) (Figure 6).

The small number of OECD countries that do not have IFIs may rely on country-specific approaches for solidifying the credibility of their forecasts. For example, in New Zealand, each economic and fiscal update is accompanied by statements of responsibility signed by the Minister of Finance and the Secretary to the Treasury.⁸

Baselines

What are baselines

The concept of baselines refer to an estimate of future expenditures over a multi-annual period, assuming that the government's policies and programmes will remain unchanged. Baselines show therefore the multi-year financial implications of current policy decisions and act as a warning of potential future financial pressures. They are the building block of multi-year budgeting, in that any attempt to allocate resources beyond one year requires reliable estimates of how much existing policies and programmes will cost in the future to assess fiscal space or gaps against fiscal objectives and take appropriate actions.

Baselines are also a powerful accountability tool in the budget process. Without a baseline, scrutiny of the budget often relies on comparing planned spending with previous budget figures or the budget outturn: this is often a misleading comparison, since circumstances necessarily change between two fiscal years. Baselines, on the contrary, quantify year-to-year variations of spending on a given policy or programme to maintain it at its current level and require explaining underlying factors for these changes. It therefore provides a neutral benchmark against which policy changes, reprioritisations, etc. can be more clearly identified and explained.

The formulation of baselines requires that several prerequisites be met – e.g. a sound budget nomenclature, reliable accounting for establishing an accurate starting point, good capacities for policy costing, a clear definition of “no policy change”, etc. The latter, in particular, is of significant operational importance.⁹

From that starting point, baselines can be prepared and updated in diverse ways, from a very aggregated one (and therefore relatively crude) to fairly detailed one. At a minimum, when they update their baselines, countries should ensure that they identify and lump together “items that may have common or similar

expenditure drivers” (Rahim, Wendling and Pedastsaar, 2022^[13]). At the other end of the spectrum, baselines are an integral part of the budget and are prepared at budget article level.

In any case, as underlined in the OECD Spending Better Framework, baselines require both top-down and bottom-up inputs – that is a combination of methodological guidance and monitoring from the ministry of finance and costing by budget entities, as a preparatory step for their budget submission.

2023 SBO Survey’s findings

Preliminary answers to the 2023 SBO survey indicate that the formulation of baselines is a common practice across all OECD countries. However, objectives, methodologies and transparency practices employed vary significantly. On one end of the spectrum, some countries have fully integrated baselines into their ongoing budgetary processes, updating them continuously. On the opposite end, there are countries where baselines are formulated independently of the budget process, serving as standalone forecasting exercises.

With regards to definition, answers to the 2023 SBO Survey highlight that only few OECD countries have a formal and public definition of baselines. For instance, in Australia, forward estimates, which are baselines in nature, are defined on the Department of Finance’s website as “a system of rolling three-year financial estimates of (...) costs of ongoing government policy decisions, after allowing for estimated movements in economic parameters.” The United States defines baselines as “a projection of the budgetary resources, outlays, and receipts for mandatory programmes and governmental receipts based generally on current law, and a projection of the CY levels of budgetary resources, outlays, and receipts into the outyears for discretionary programmes.”

Public disclosure of the methodology underpinning the preparation of baselines serves as a safeguard for quality by introducing transparency and accountability into the process, and also allowing for peer review and external validation. However, publication is not standard practice. The United States is an exception in publishing a public and detailed methodology for the development of baselines.¹⁰ Other countries do not publish this information, or do it, sometimes briefly, as part of the budget circular. The latter approach is used for instance for France.

With regard to updating baselines, the prevailing approach among OECD countries is an annual update, a practice followed by 25 countries. In other cases, updates may occur at least two times a year, timed to precede major budgetary events. For instance, in Australia, updates are done ahead of the main budget event and mid-year economic and fiscal update. Within this group of countries, a number of respondents note that additional updates may be done that are intended solely for internal use (e.g. Australia and Sweden). In the United States, it is notable that the baseline is updated for the effects of any legislation enacted or administrative actions taken since the President's Budget request was released and any new legislation is scored using the assumptions that underlie the baseline submitted with this request.

Typically, these updates are collaboratively carried out by the Ministry of Finance and line ministries (25 countries). In approximately half of these countries, the Ministry of Finance assumes the leading role, while in the remaining countries, the initiative lies with the line ministries. This shared responsibility may be exercised in different ways. For instance:

- In Australia, baselines are prepared by line ministries, with economic parameters provided by the ministry of finance.
- In Sweden, baselines updates are managed by line ministries, with their categorisation as baselines “affected by macroeconomic developments” and baselines that are not pre-agreed between the Ministry of Finance and the respective line ministries.

- In France, baselines are calculated separately by the Ministry of Finance and by line ministries, then agreed as part of the budget negotiations that take place before the determination of expenditure ceilings.

For a small group of respondents, responsibility for the baseline update lies only with the budget office (6 countries). For instance, in Costa Rica, the baseline update is a responsibility of specific team that also prepares the government's multi-annual fiscal framework.

Practices with disclosure of baselines are very variable. In some cases, baselines are prepared and published at the same level of detail as the budget, allowing each year's budget to contain a reconciliation between its own figures and the first outer year in the previous year's forward estimates. This has been the case for instance for decades in Australia and has been adopted more recently in France, as part of a package of reforms aimed strengthening budget processes and transparency.

Further, some countries provide detailed explanations on changes to baselines. For instance, in the case of Canada, the budget documentation includes information on variations since the previous baseline forecast, differentiating between impacts of economic and fiscal developments, actions with existing policies and inclusion of new measures.

However, the 2023 SBO Survey's results also show room for improvement in transparency practices. In particular, baselines do not seem to be always disclosed in the national budget documentation. For instance, in the case of European Union member states, some countries indicated that baselines information was provided only in their stability programme transmitted annually to the European Commission, which includes a "no policy change" fiscal forecast. Also, baselines are sometimes disclosed only as an aggregate forecast for all government spending (i.e. a single figure), hence limiting their usefulness for both medium-term budgeting and accountability mechanisms.

Expenditure ceilings

What are expenditure ceilings

Expenditures ceilings are a restriction on spending level(s) established in advance of the preparation of the budget. The setting of expenditure ceilings is a top-down process, in that it is an early announcement by the government to budgetary entities on the authorised level of expenditure to ensure consistency with the country's fiscal targets. In the context of medium-term budgeting, expenditure ceilings can be set on a multi-annual basis and therefore apply to successive budgets, which supports fiscal responsibility and predictability for budgetary entities.

To operate a system of multi-year expenditure ceilings, one of the most important decisions to make is in what manner, and how far in advance, the ceilings will be set. There are three inter-linked decisions to be made in that respect, which are:

- whether expenditure ceilings should be binding (i.e. they cannot be modified) or indicative.
- whether the ceilings should be revised on a rolling basis (i.e. ceilings are annually updated by adding an outer year) or fixed.
- which period the expenditure ceilings should cover (usually between 3 to 5 years).

In using multi-annual expenditure ceilings, in particular in the case when these ceilings are binding, governments aim in essence to separate decisions on expenditure levels from variations in macroeconomic and fiscal forecast. In other words, once an expenditure ceiling has been set based on realistic macroeconomic and revenue forecasts, actual macroeconomic developments and realisation of fiscal risks should not affect, or affect only in a limited way, the next year's ceiling. To achieve this, most

OECD countries have traditionally set allowances for emergencies and future spending pressures within their multi-year spending plans (OECD, 2019^[10]).

Whether expenditure ceilings should be set at aggregate level or at ministry or programme level is another key decision to make for countries. While the aggregate ceiling operationalises the government's high-level fiscal objective(s) and is a collective responsibility of the government, sectoral-level ceilings provide individual ministers with a precise indication of how they are expected to contribute to the collective effort – i.e. in the latter case, a ceiling is set at the level where someone can be made responsible for enforcing it. Although some budget specialists consider that the two types of ceilings complement each other, others underline challenges with “[maximising] line ministry budget certainty while at the same time maximising the control of aggregate expenditure” (Robinson, 2022^[14]).

2023 SBO Survey's findings

A first notable finding from the 2023 SBO survey is that a significant group of 10 OECD countries does not use multi-annual expenditure ceilings as part of their budget systems:

- 1 country (Italy) indicates that although legislation authorises the use of expenditure ceilings, these have not been used yet in practice.
- 2 countries (Australia and Belgium) indicate that they publish multi-annual expenditure forecasts that are not ceilings in nature.
- 7 countries (Chile, Costa Rica, Japan, Korea, Luxembourg, Norway and Spain) use expenditure ceilings for a single budget, which means that their system of budgeting is top-down in nature but the top-down upper limit on the level of government expenditure is determined for only one-year.¹¹

In addition, one country (New Zealand) uses multi-annual indicative allowances rather than expenditure ceilings per se. These allowances are in nature a management tool to ensure fiscal targets are achieved. They however receive extensive legislative and public scrutiny, for example with significant debate about the sufficiency of these allowances in the pre-election fiscal update leading up to the election. As allowances are utilised they are incorporated into the actual results, for example in the audited actual operating expenses numbers. Extensive explanation as to why these numbers differ from budget is provided in the commentary to the financial statements and is examined by the Finance and Expenditure select committee and the media.

The 2023 SBO survey's answers highlights that what constitutes a multi-annual expenditure ceiling may be subject to interpretation. Through either a multi-annual ceiling, indicative allowance or forecast, a government makes an early announcement on the future levels of expenditure. What best differentiates these three approaches is maybe the nature of the commitment made by the government. In the case of a simple forecast, it can be argued that there is no commitment at all. With allowances, a government may aim mainly at providing a level of transparency and predictability on future resources allocations. In the case of a ceiling, the government makes an explicit commitment not to exceed a certain level of expenditure. The greater credibility and certainty provided in theory by an expenditure ceiling however depends on how they are implemented. It could be argued indeed that the difference between a ceiling, in particular if it is indicative, and an allowance may be blurred. New Zealand is a point in case: it sets allowances for a four-year period on a rolling basis and these allowances, which are divided into “operating” and “capital,” are generally adhered to, are very similar to expenditure ceilings.

Types of multi-annual expenditure ceilings

Within the group of 26 OECD countries that use expenditure ceilings on a multi-annual basis (Table 2), a variety of practices can be observed:

- A majority of respondents (14 countries) set expenditure ceilings over a 4-year period; while 8 countries use a three-year period, and 3 countries use a five-year period. One country, the United States, stands out by setting expenditure ceilings over a 10-year period. These indicative top-down expenditure ceilings are included in the President's budget.
- A large majority of respondents (20 countries) use rolling ceilings, meaning that a ceiling for the next outer year is added annually, and 6 countries use fixed ceilings, which are revised only after the full time-period covered by the medium-term framework is completed.
- Respondents are almost evenly split between the use of binding and indicative ceilings. A quarter of respondents (9 countries) use binding ceilings over the full time period of their medium-term framework and a smaller group (3 countries) use binding ceilings only for a 2-years period. Other respondents (14 countries) rely on indicative ceilings.

Table 2. Types of multi-annual expenditure ceilings, 2023

Country	Time period	Rolling	Fixed	Binding	Indicative
Austria	4-years	X		T1+3	
Canada	5-years	X			T1+4
Colombia	4-years	X			T1+3
Czechia	3-years	X		T1+2	
Denmark	4-years	X		T1+3	
Estonia	4-years	X		T1	T1+3
Finland	4-years		X	T1+3	
France (a)	3-years	X		T1	T1+2
Germany	4-years	X		T1+3	
Greece	4-years	X		T1+1	T1+3
Hungary	3-years	X			T1+2
Iceland	5-years	X		T1+4	
Ireland	3-years	X		T1	T1+2
Israel	4-years	X		T1	T1+3
Latvia	3-years	X		T1+2	
Netherlands	4-years		X	T1+3	
New Zealand	4-years	X			T1+3
Poland	3-years	X		T1	T1+2
Portugal	4-years	X		T1	T1+3
Slovak Republic	4-years		X	T1	T1+3
Slovenia	4-years		X	T1+1	T1+3
Sweden	3-years	X		T1+2	
Switzerland	4-years	X		T1	T1+3
Türkiye	3-years	X		T1	T1+2
United Kingdom (b)	5-years		X	T1+1	T1+4
United States	10-years		X	T1 (c)	T1+9 (d)

Note: T1 is the upcoming budget year. Only countries that use expenditure ceilings beyond T1 + 1 are shown in this table. Table shows up to which year either binding or indicative ceilings are used. (a) France did not have a multi-year programmatic law at the time of this survey. The most recent law used fixed ceilings over a five-year time period, (b) In the United Kingdom, top-down expenditure ceilings are set at Spending Reviews (SRs), (c) In the United States, the legislature can provide top-down expenditure ceilings for T1 for Appropriations subcommittee level (called 302(b) allocations). Appropriations enacted by the legislature provide top-down ceilings, (d) The President's budget request provides indicative top-down expenditure ceilings based on the President's policies over the ten-year period. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q16 and 19.

Granularity of multi-annual expenditure ceilings

Concerning the granularity of multi-annual expenditure ceilings (Table 3):

- Only 2 countries set ceilings only at aggregate level over the whole time-period covered by the expenditure ceilings. Denmark sets its ceilings at quasi-aggregate level – that is for main sectors of general government (central, regional and municipalities) and by broad types of expenditures (operating and transfers).
- About half of all countries (13 countries out of 25 countries) use organisational-level ceilings for the full time-period of their medium-term framework.
- Other countries use a mix of organisational-level ceilings in initial years of their MTEF and aggregate level for other years.

In addition, sub-ceilings for selected expenditure areas are sometimes used, in a majority of cases for wages (15 countries) and operating expenditures (10 countries). Their role is to either put a limit on certain types of expenditures or alternatively to ringfence them. In the latter case, the emphasis is on achieving allocative efficiency by setting a spending target. For instance, New Zealand had used such budget envelopes recently for COVID recovery and climate response policies. The United Kingdom also uses ceilings called “ringfences” for certain programmes and policies.

Table 3. Granularity of multi-annual expenditure ceilings, 2023

Country	Time period	Total expenditure level	Organisational level	Programme level	Other
Austria	4-years	T1	T1 + 3		
Canada	5-years			T1+4	
Colombia	4-years				T1+3 (a)
Czechia	3-years	T1 + 2	T1 + 2	T1 + 2	
Denmark	4-years				T1 + 3 (b)
Estonia	4-years		T1 + 3		T1 + 3 (c)
Finland	4-years	T1 + 3			
France	3-years	T1 + 2	T1 + 2	T1 + 2	
Germany	4-years	T1 + 3	T1 + 3		T1 + 3 (d)
Greece	4-years		T1 + 3		
Hungary	3-years		T1 + 2		
Iceland	5-years	T1	T1	T1+4 (e)	
Ireland	3-years	T1+2	T1+2	T1	
Israel	4-years	T1 + 3	T1 + 3	T1	
Latvia	3-years	T1 + 2		T1	
Netherlands	4-years	T1 + 3	T1 + 3		
New Zealand	4-years				T1+3 (f)
Poland	3-years	T1 + 2	T1 + 2	T1 + 2	
Slovak Republic	4-years	T1 + 3	T1 + 2		
Slovenia	4-years	T1+2	T1+1	T1+3	T1+1 (g)
Sweden	3-years	T1 + 2			(h)
Switzerland	4-years	T1+3			
Türkiye	3-years	T1 + 2	T1 + 2		
United Kingdom	5-years	T1 + 4	T1 + 1	(i)	
United States	10-years	T1+9	T1+9	T1+9 (j)	

Note: T1 is the upcoming budget year. Only countries that use expenditure ceilings beyond T1 + 1 are shown in this table. Table shows up to which year a level of granularity is used. (a) Other for Colombia: Ceilings by sector (e.g. education, health, defence), (b) Other for Denmark: Ceilings by sector (state, municipality, regions) and type (expenditure, transfers), (c) Other for Estonia: Top-down expenditure ceilings are set on ministerial level (on current expenditure and investments) and on performance area level (on current expenditure). Ministerial level expenditure ceilings include one or several performance areas, (d) Other for Germany: Additional restrictions for line ministries in top down-decision are possible, (e) Programme level for Iceland: The ceilings are set out for 35 expenditure areas. The ceilings are divided into appropriations by expenditure and economic functions and shown for each line ministry. Those appropriations are then divided further by each minister into agencies and projects, (f) Other for New Zealand: Operating Allowances (for decisions impacting operating revenues and operating expenses) and Capital Allowances (for decisions impacting capital expenditure), (g) Other for Slovenia: Ceilings by group of budget items, (h) Other for Sweden: The framework includes an aggregate expenditure ceiling, combined with frames for the 27 expenditure areas that make up the budget., (i) Programme level for the United Kingdom: Not set except in limited circumstances, for example the 2020 Spending Review provided multi-year funding to build 40 new hospitals. (j) Programme level for the United States: for the legislative branch (binding ceiling for T1): Programs in the jurisdiction of the Appropriations Committees receive top-down ceilings in permanent law, typically on a yearly basis. For Portugal, information on the granularity level of the multi-annual expenditure ceilings is not available. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q17.

Flexibility and credibility of multi-annual expenditure ceilings

Within the group of 26 OECD countries that use expenditure ceilings on a multi-annual basis, only a small group of countries (3 countries) set their expenditure ceilings in real terms set their expenditure ceilings in real terms, under which deviations from the underlying fiscal forecasts due to inflation will not affect the spending envelope.

All other countries (23 countries) use nominal expenditure ceilings, which, in “normal times,” allow for simpler implementation and monitoring. However, they become more difficult to set and comply with in a high inflation environment although they can play a counter-cyclical role. Accordingly, revisions of nominal ceilings for out-years are in most cases authorised – only 3 countries that use nominal ceilings do not authorise such revisions. These revisions are done once per year in 12 countries and as needed in response to changes to forecasts in 3 countries.

The benefits of expenditure ceilings may however be undermined by too frequent and/or ill-timed revisions. Therefore, in order to manage the competing demands of flexibility and credibility, OECD countries follow mainly two approaches:

- Firstly, expenditure ceilings may exclude cyclically sensitive spending. For instance, in Denmark, unemployment-related spending is excluded from the ceilings. In both cases, credibility and usefulness of the ceilings is unaffected as they still cover a significant share of public spending.
- Secondly, risks of large downward revisions to macroeconomic forecasts may be mitigated with the inclusion of a budget margin or reserve in the aggregate expenditure ceiling and/or the lower-level expenditure ceilings.

The main challenge with using a budget margin or reserve within expenditure ceilings is that it should be large enough to absorb potential additional spending needs or realisation of some fiscal risks, but small enough to avoid diluting fiscal discipline and constraining unduly much needed spending in key policy areas. Because of these difficulties, some countries, for instance Germany or the Netherlands, do not use them.

In other countries, reserves are set in a variety of ways that reflect each country's circumstances. It is to be noted that purpose of budget margins or reserves may be defined in a way that is limitative enough that it does not open the door to new spending requests from budgetary entities. In the case of Sweden, for instance, the government uses an official guideline for the minimum size of the budgeting margin, which is primarily aimed at providing a buffer for adverse changes in macroeconomic developments. The United Kingdom sets for instance a reserve for “genuinely unforeseen contingencies.” In the case of Denmark, only the subceiling for transfers includes a reserve (set at 1% of total transfers).

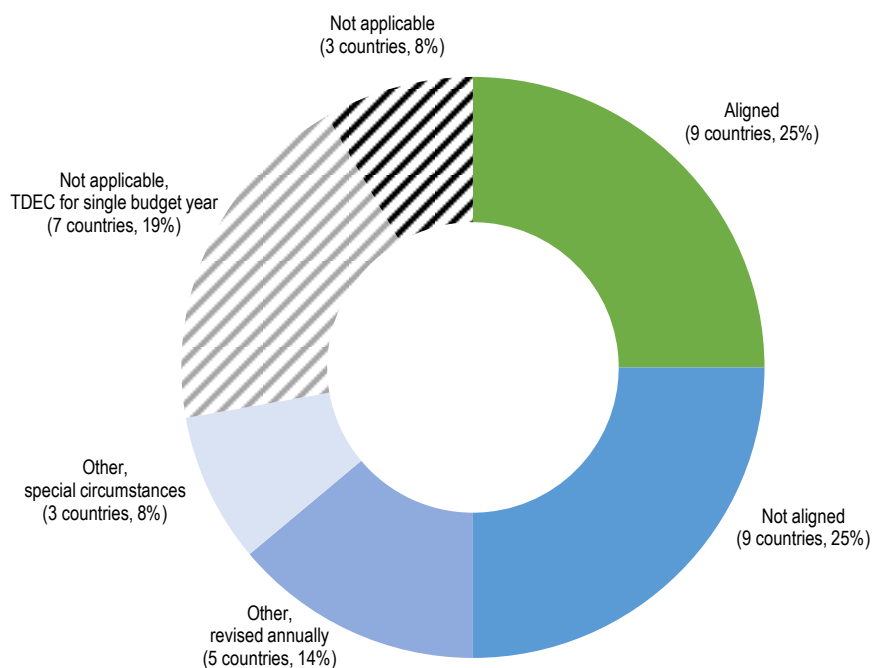
Finally, it is to be noted that countries that do not use expenditure ceilings may also use reserve or budgetary margins. For instance, Australia has a “contingency reserve” for unforeseen events and uses a “conservative bias allowance, calculated within the contingency reserve, which provisions for the tendency for the estimate of expenses for existing policy to be revised upwards in the forward years.

Effectiveness of expenditure ceilings

At the time of the 2023 SBO Survey, expenditure ceilings set in a given year are in a majority of cases not complied with beyond the budget prepared that same year and executed the next year. Indeed, as already noted above, to the question “is the most recent approved budget consistent with the multi-annual top-down expenditure ceiling set in the previous year?,” only about a third of OECD countries with multi-annual expenditure ceilings, or 9 out of 26 countries, answered positively (Figure 7). This means that, for other respondents that use multi-annual expenditure ceilings (17 countries), previous year’s expenditure ceilings are not effectively constraining budgetary decision making for the next year.

Reasons reported by respondents include exceptional circumstances (3 countries) and the fact that ceilings (binding or indicative) are revised annually, meaning that the budget is aligned with the revised ceiling instead of the previous year’s one (5 countries). In the latter case, a fundamental objective of an expenditure ceiling system, which is to separate decisions on expenditure levels to the extent possible from variations in macroeconomic and fiscal forecast, is therefore weakened. This also suggests, more generally, that budgetary decision-making processes, budget calendars, as well as forecasting techniques, including in relation to baselines are not always effective in supporting the top-down and multi-year budgeting system.

Figure 7. Consistency between most recent approved budget and the previous year’s expenditure ceiling, 2023



Note: TDEC stands for Top-Down Expenditure Ceilings. Countries have been classified under relevant categories by authors based on answers and narrative information provided in the survey. Data for Lithuania and Mexico are not available.

Source: 2023 OECD SBO Survey on Budget Frameworks, preliminary results for 36 countries, Q27.

Further, answers to the survey reveal that, within the group of 26 countries that use multi-annual expenditure ceilings, only a smaller group of 20 countries formally scrutinise the deviations between their

expenditure ceilings and actual spending, and only 13 countries within that group publish this information. This, coupled with the finding that only a limited group of country has recently complied with their expenditure ceilings, highlights that the “robust monitoring and enforcement mechanisms [to ensure] that actual spending is in line with the expenditure ceilings” advised in the OECD Spending Better Framework are not yet widespread practice.

Against this background, it is notable that, in the same way that independent input into the forecasting process can serve to bolster its credibility, it has been suggested that such independent input could also support the credibility of government spending plans and expenditure ceilings. For instance, the European Union may introduce an enhanced role for its member countries’ IFIs, which would require them to provide an independent opinion on compliance with the net public expenditure path set out annually by EU countries in their “national medium-term fiscal-structural plan.” It is also notable that, in France, the mandate of the IFI was extended in 2021 to include the provision of an opinion on the consistency between the government’s Public Finances Programmatic Law, which is a MTEF in nature, and planning laws enacted for sectors such as justice or defence.

Conclusions and policy recommendations

Conclusions

Budget systems in OECD countries have been put to the test during the COVID-19 pandemic: fiscal objectives and top-down and medium-term budgeting systems have been suspended in many countries to allow for the operation of automatic stabilisers and emergency spending (OECD, 2020^[15]). Accordingly, debt and deficit levels have soared. Both developments could have triggered updates and revisions to pre-pandemic fiscal frameworks. However, in contrast with the wave of PFM reforms post-global financial crisis and Eurozone debt crisis, the preliminary results of the 2023 SBO Survey signal that only a limited number of OECD countries have thus far engaged in reforms.

This paper’s findings suggest that such reforms might be needed. Fiscal rules or objectives are used by all OECD countries, but sometimes lack credibility due to recent breaches or frequent changes. Their multiplicity can in some cases generate a complex and suboptimal web of constraints for budgetary management and can also impair clarity over the government’s fiscal intentions. Deviations from expenditure ceilings stated in MTEFs or other budget documents are frequent and not always explained. Overall, this points to a possible risk of over-reliance for fiscal policy on a myriad of fiscal rules and objectives, as an antidote to weaknesses in top-down and medium-term budgeting. This is problematic because fiscal objectives are stating an intention, but it is top-down and medium-term budgeting that ultimately make these intentions concrete.

Against this background, issues of effectiveness with top-down and medium-term budgeting appear to come down to two reasons:

- The first one is structural. Budgetary institutions, rules and processes in OECD countries are not always effective in supporting the top-down and multi-year budgeting system. First, baselines are sometimes prepared without a sound definition or at aggregated level, making them of limited use for budgetary management. Updates are often too infrequent. There are also noted limitations regarding transparency. Top-down expenditure ceilings are widely used but often not effective in practice in constraining spending beyond one budget year, due to frequent revisions or in the absence of clear enforcement and flexibility rules. Maybe more importantly, the various processes underpinning medium-term budgets are not properly integrated. Expenditures ceilings may be decided even in the absence of reliable multi-year baselines; expenditure baselines may be calculated aggregated level making them an irrelevant input for the budget formulation process, etc.

- The second one is, possibly, conjunctural. Fiscal objectives and expenditure ceilings have been suspended in many instances during the COVID-19 crisis and decision-makers have been sometimes reluctant to reinstate immediately and fully systems and processes that constrain their capabilities to act and spend quickly in the current context of the ongoing “poly-crisis”. As of today, major policy decisions continue being made outside of the main budget event, for instance through sectoral planning law, framework laws or emergency laws, which are in some cases not clearly defined in terms of their budgetary impact. Fundamentally, budgeting is about defining a set of rules and procedures for spending decisions and, in turn, to prevent spending decisions outside these boundaries. When these rules and processes are not complied with, this, in turn, weakens top-down and medium-term budgeting processes.

Policy recommendations

Against this background, strengthening medium-term and top-down budgeting will be critical for countries to navigate the fiscal challenges of the post-COVID environment. This is because:

- Extending the time-horizon of budgetary decision-making, and therefore committing resources over a multi-annual basis, is necessary to deliver policy agendas that have medium to long-term implications. Climate-related disasters, and public investment for the green and digital transition are some of these longer-term policy agendas that medium-term budgets can help to address (Radu, 2023^[16]).
- Defining spending limits based on the economic forecast, estimates of future spending on current policies (or baselines) and the government’s fiscal objectives fosters effective expenditure prioritisation aligned with both the government fiscal strategy and policy priorities.

Concerning medium-term budgeting, countries should aim at strengthening processes and increasing transparency over baselines, as these constitute the building block for credible expenditure ceilings. They may consider in particular the following:

- **Publishing baselines and the methodologies underpinning them with appropriate level of detail**, so that baselines can play their full role in the determination of expenditure ceilings, budget formulation as well as accountability mechanisms.
- **Implementing infra-annual updates of baselines**, so that these can provide an early warning on fiscal impacts of policy decisions made outside of the annual main budget event, which have increased during and in the wake of the COVID-19 pandemic as noted above, and their implications vis a vis fiscal rules or objectives.

Concerning expenditure ceilings, across the group of countries whose most recent budget was consistent with the multi-annual top-down expenditure ceilings set in the previous year, a shared objective is the *credibility* of the ceilings. How this credibility is achieved varies, but almost all countries within this group operate frameworks that have simplicity and coherence, stability over time and embedded but limited flexibility. Common features in how these countries set their expenditure ceilings, which may be considered by countries that aim to strengthen their own processes, are as follows:

- **Committing to early political decision-making on spending envelopes**. Different approaches are used, reflecting each country’s circumstances. For instance, in the Dutch system, ceilings are anchored in a coalition agreement between parties in government. In the United Kingdom, the formulation process for discretionary expenditures ceilings is simultaneously a spending reviews phase.
- **Using binding ceilings at least up to one year after the upcoming budget year**, which provides credibility to the medium-term budgeting process.
- **Setting ceilings at both aggregate and detailed level**. While establishing a binding expenditure ceiling at aggregate level is an important signal for fiscal responsibility signal, indicative sectoral ceilings, set with appropriate flexibility, are also useful in that they allow that i) a decision-maker,

typically a minister, can be made responsible for enforcing the ceiling and ii) they can also be used to frame the annual budget discussions.¹²

- **Ensuring credibility of the ceilings**, which requires considering trade-offs between various parameters including comprehensiveness of the ceilings, exclusion of expenditures that are cyclically sensitive and/or would be challenging to manage and restrict, the size of the budget margin or reserve, etc.
- **Defining clear rules with regards to compliance with ceilings and approaches to reopening or revising these ceilings**, which fosters responsibility, discipline and collective rationality. For instance, in the case of Denmark, each minister is legally obliged to act appropriately to comply with her or his ceiling for the current year, although a general compensation mechanism can be used in exceptional cases.¹³

Equally crucially, countries need to **design their medium-term and top-down budget processes in a way that is fully integrated**. Typically, baselines should be updated at key stages of the budget cycles; be detailed enough that they are the main input to the annual setting of expenditure ceilings and budget negotiations; etc. For instance, in Sweden, baselines updates are the building block for adjustments to sectoral expenditure ceilings presented in the mid-year budget bill.

Finally, by reinforcing their top-down and medium-term budget systems, countries may find opportunities to **strike a better balance between the use of fiscal rules and objectives, medium-term budgets and expenditure ceilings in their fiscal frameworks**. This would help them to avoid relying excessively on the former.

Countries should also consider using the **full range of approaches to reducing bias in macroeconomic and revenue forecast**, including i) strengthening the role of IFIs and ii) imposing stricter quality requirements for government forecasting, including benchmarking with relevant external forecasts.

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Notes

¹ Responses are from Australia, Austria, Belgium, Canada, Chile, Colombia, Costa Rica, Czechia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Türkiye, the United Kingdom and the United States. Data for Lithuania and Mexico are not available.

² The World Bank identifies three types of medium-term expenditures frameworks, or MTEFs, by stage of development. These stages, from the least to most advanced stage, are as follows: (1) the medium-term fiscal frameworks or MTFFs, which reconcile fiscal policy objectives with aggregate expenditure and revenue estimates; (2) medium-term budget frameworks, or MTBFs, that further detail expenditure estimates, usually at same granularity than the annual budget; and (3) medium-term programme frameworks, or MTPFs, which present expenditures forecasts by programmes linked to medium-term outputs and outcome targets.

³ https://assets.publishing.service.gov.uk/media/63d15c6cd3bf7f3c4900f11a/Charter_for_Budget_Responsibility_-_AS22_-_FINAL_as_published_in_draft.pdf

⁴ Within countries that use systems of automatic correction, it is especially notable that Poland and the Slovak Republic have a system of progressive “preventive triggers” for fiscal adjustment when debt level rises close to its ceiling.

⁵ A country can deviate from an anchor numerical objective in case of a crisis but is expected to return to the anchor level over the medium-term.

⁶ https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6562

⁷ Other core function and mandates, which are not discussed in this paper, may include monitoring compliance with fiscal rules, policy costing, long-term fiscal sustainability analysis, and supporting the legislature in budget analysis.

⁸ This statement attests that all policy decisions or circumstances with material economic and fiscal implications known to the government have been communicated to the Treasury and included in the forecasts, and that the Treasury has used its best professional judgment in their preparation.

⁹ “No policy change” can have different interpretations, including “current services” or “current legislation”. Current services means continuation of current service levels (including impacts of demographic changes and cost changes but excluding policy changes that may be decided in future years). “Current legislation” means continuation of services that are required by law, but not all other services (mostly investments). How “no policy change” is defined may be different between countries and has an impact on how baselines should be interpreted.

¹⁰ <https://www.whitehouse.gov/wp-content/uploads/2018/06/s80.pdf>

¹¹ A top-down expenditure ceiling can be defined for one year along with the production of a medium-term forecast.

¹² An “indirect approach” is for instance followed by Finland and Sweden. In Finland, an aggregate, fixed and binding expenditure ceilings is set for the 4-year parliamentary term, but indicative “spending limits” are also defined for each ministry over the same period on rolling basis. In Sweden, an aggregate and binding expenditure ceiling is set for 3 years on a rolling basis by Parliament. These ceilings are then divided into “frames” that are equal to the sum of appropriations for a given spending area. The frames form the basis for annual negotiations between the ministry of finance and ministries and may be revised as part of the annual budget discussion.

¹³ Ceilings can however be redistributed between sectors (state, municipalities, regions) as part of the yearly budget negotiations within the limits of the aggregate ceiling.

The emergence of strategic budget initiatives

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The growth of strategic budget initiatives – such as gender budgeting and green budgeting - has been a prominent trend in OECD countries. This is driven by a desire to use the budget to help deliver transformational change in relation to key policy priorities demanding a whole-of-government response. This paper outlines the emergence of strategic budget initiatives across OECD countries and offers some preliminary observations on how these initiatives are being designed and implemented.

JEL classification: H61: Public Economics / National Budget, Deficit, and Debt / Budget; Budget Systems

Keywords: strategic budget initiatives, gender budgeting, green budgeting, priority budgeting

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Executive summary

The growth of strategic budget initiatives – such as gender budgeting and green budgeting - has been a prominent trend in OECD countries. This is driven by a desire to use the budget to help deliver transformational change in relation to key policy priorities demanding a whole-of-government response. Strategic budget initiatives allow governments to signal the importance of certain cross-cutting policy priorities, both externally to citizens, as well as internally to the administration. They provide the impetus for more inter-connected thinking, allowing governments to address key policy issues through a more systematic and clearly defined manner. In addition, they respond to pressures for increased transparency and accountability in government spending and a greater focus on evidence-based policy making.

Gender budgeting was the first strategic budget initiative in many OECD countries. It was introduced in Australia in the 1980's and is now practised by 61% of OECD countries. Green budgeting gained prominence more recently, particularly after the establishment of the OECD Paris Collaborative on Green Budgeting in 2017. Despite green budgeting being a more recent phenomenon, its prevalence across OECD countries is now on a par with gender budgeting. A few countries also practise SDG budgeting, well-being budgeting, and youth and child budgeting.

Four out of five OECD countries (79%) have one strategic budget initiative in place and a growing number of countries are also employing more than one type of strategic budget initiative. Five OECD countries implement three or more. Overall, countries are looking for public governance mechanisms that can help effect transformational change in relation to key policy priorities demanding a whole-of-government response.

This paper presents seven preliminary observations about the emergence of strategic budget initiatives, as well as their use and sustainability across OECD countries:

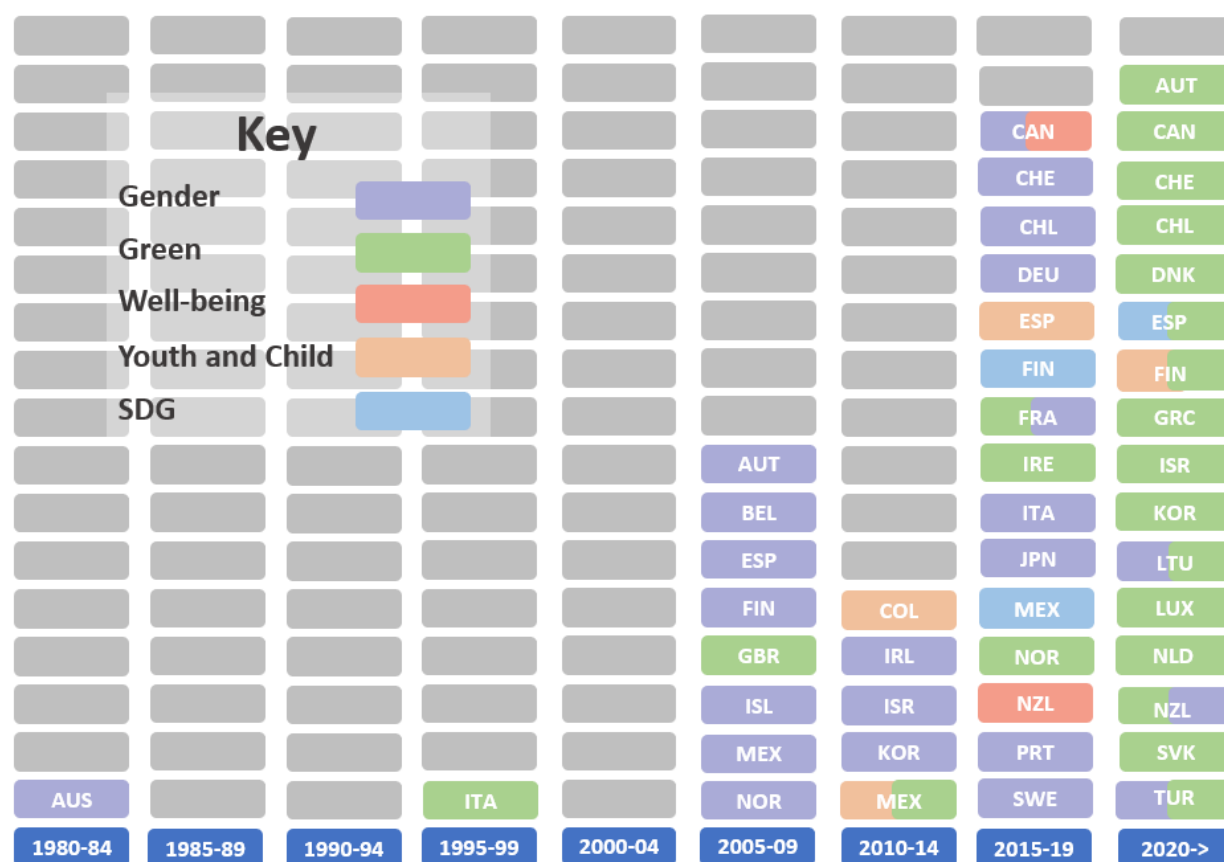
1. Gender budgeting has served as a 'trailblazer' for other strategic budget initiatives.
2. The implementation of strategic budget initiatives varies from superficial to deep-seated.
3. To effectively manage strategic budget initiatives, central budget authorities may need to take on new roles and acquire new competencies.
4. Strategic budget initiatives depend on diverse tools and methods to assess the impact of budgetary measures on policy priorities, with some tools being specific to each initiative and others being common across various initiatives.
5. The emergence of strategic budget initiatives has sparked a rise in themed budget statements.
6. Governments are exploring methods to align and interconnect multiple strategic budget initiatives and the role of digital tools.
7. As many strategic budget initiatives are still relatively new, it remains to be seen if they can achieve their intended outcomes and whether they will be able to withstand political change.

The growing use of strategic budget initiatives in OECD countries

Budget practices have evolved in recent years, reflecting the growing complexity of public policy challenges and the need for more effective resource allocation. The challenges in linking resource allocation to overarching objectives, breaking down silos, and ensuring policy coherence across government agencies have led to the exploration of new approaches. Strategic budget initiatives have emerged as a prominent solution, aiming to enhance the effectiveness of government resources in achieving cross-cutting priorities and broader goals. In this way, they support governments in aligning budgets more closely with the medium-term strategic priorities of government. Although the first strategic budget initiatives were implemented by OECD countries in the 1980s and 1990s, their use has gathered pace in recent years. They are now a budgeting tool in place in 79% of OECD countries (30 out of 38 countries) (see Figure 8).

Figure 8. The emergence of strategic budgeting initiatives across OECD countries, 1980-2022

Introduction of strategic budgeting initiatives by year



Source: Developed by the OECD (2023).

Note: There is no set of minimum practices that a country must adhere to in order to report that it has implemented a strategic budget initiative. This lack of standardisation makes it challenging to pinpoint the precise year when these initiatives emerged in various countries. As such, while all attempts for accuracy have been made, the above dates may change depending on interpretation.

Australia was the first OECD country to introduce a strategic budget initiative, pioneering gender budgeting in the 1980s. It published its first women's budget statement in 1984, tabled as a budget paper in parliament by the Prime Minister on budget night (Sharp, 1990^[1]). Publication of the women's budget statement ceased thirty years later in 2014. However, in the interim several OECD countries, including Austria, Belgium, Finland, Iceland, Mexico, Norway and Spain picked up on this new tool of budgeting. The 1995 Beijing Declaration and Platform for Action may have been influential in spurring OECD countries to put gender budgeting into practice, given its call to integrate a gender perspective into government budget processes. A further wave of OECD countries began implementing gender budgeting in the most recent decade, as gender equality and its potential economic and fiscal benefits became increasingly recognised (Nicol, 2022^[2]). Global social movements and initiatives, like #MeToo and #TimesUp, have increased pressure on policymakers to act. The COVID-19 pandemic also gave increasing recognition to the persistence of gender inequalities and the need for applying a gender lens in policy development (OECD, 2022^[3]). Gender budgeting is now practiced by 23 (61%) OECD countries (OECD, 2023^[4]). This includes Australia, where the women's budget statement has been reintroduced in recent years.

Following gender budgeting has been the emergence of green budgeting. While countries like Italy and the United Kingdom have had green budgeting methods in place for many years now, the launch of the OECD's Paris Collaborative for Green Budgeting at the One Planet Summit in 2017 marked the beginning of a new growth era for the novel budgeting initiative. Against the backdrop of a growing recognition of the risks posed by climate change, many additional OECD countries have since introduced green budgeting, bringing the prevalence of green budgeting on a par with gender budgeting (OECD, 2023^[5]).

In parallel with the widespread adoption of gender budgeting and green budgeting, a small number of OECD countries have also pioneered other strategic budget initiatives, such as well-being budgeting, SDG (Sustainable Development Goal) budgeting and youth budgeting.

Well-being budgeting, spearheaded in New Zealand, prioritises the improvement of social, environmental and economic goals through the budget. This approach has gained momentum in recent years as governments look for ways to create more sustainable and equitable economic growth. SDG budgeting aims to help government implement commitments made under Agenda 2030. Youth and child budgeting have emerged in response to growing concerns about child poverty and intergenerational equity.

Overall, the growing interest is being driven by a desire to use the budget to help deliver transformational change in relation to key policy priorities demanding a whole-of-government response. Strategic budget initiatives allow governments to signal the importance of certain cross-cutting policy priorities, both externally to citizens, as well as internally to the administration. They provide the impetus for more interconnected thinking, allowing governments to address key policy issues through a more systematic and clearly defined manner. In addition, they respond to pressures for increased transparency and accountability in government spending and a greater focus on evidence-based policy making. They do this by providing an improved evidence base upon which resource allocation decisions can be made. The publication of this information also provides greater transparency on the impact of the budget on different policy objectives. This enables stakeholders, such as parliament and citizens, to hold the government to account on whether resources have been allocated in a way which aligns with government objectives and political promises.

As interest in strategic budget initiatives has grown, it has become increasingly common for OECD countries to implement multiple strategic budget initiatives (see Table 4). Of the 30 OECD countries that currently practice some type of strategic budget initiative, 13 countries (43%) practice one initiative, while 17 countries (57%) practise two or more. Five countries implement three or more strategic budget initiatives (Canada, Finland, Mexico, New Zealand and Spain).

Table 4. Mapping the use of strategic budget initiatives in OECD countries, 2023

Country	Gender budgeting	Green budgeting	Well-being budgeting	Youth and child budgeting	SDG budgeting	Notes
Australia	✓	✗	✓	✗	✗	Developing approach to well-being budgeting.
Austria	✓	✓	✗	✗	✓	Ministries can voluntarily include SDG indicators as part of performance budgeting.
Belgium	✓	✗	✗	✗	✗	
Canada	✓	✓	✓	✓	✗	Canada's approach to well-being budgeting is "Quality of Life budgeting". Canada also presents expected inter-generational impacts of budget decisions.
Chile	✓	✓	✗	✗	✗	
Colombia	✓	✓	✗	✓	✗	Uses markers in the budget to track child related spending.
Costa Rica	✓	✗	✗	✗	✗	Developing approach to gender budgeting.
Czechia	✗	✗	✗	✗	✗	
Denmark	✗	✓	✗	✗	✗	
Estonia	✗	✗	✗	✗	✗	
Finland	✓	✓	✗	✓	✓	SDG budgeting is referred to as phenomenon budgeting.
France	✓	✓	✗	✗	✗	
Germany	✓	✗	✗	✗	✓	Developing approach for SDG budget tagging.
Greece	✗	✓	✗	✗	✗	
Hungary	✗	✓	✗	✗	✗	Developing approach for green budgeting.
Iceland	✓	✗	✓	✗	✓	
Ireland	✓	✓	✓	✗	✓	Developing approach for well-being budgeting and SDG budgeting.
Israel	✓	✓	✗	✗	✗	
Italy	✓	✓	✓	✗	✗	Link well-being indicators to economic and budgetary programming.
Japan	✓	✗	✗	✗	✗	
Korea	✓	✓	✗	✗	✗	

Country	Gender budgeting	Green budgeting	Well-being budgeting	Youth and child budgeting	SDG budgeting	Notes
Latvia	✗	✓	✗	✗	✗	Developing approach to green budgeting.
Lithuania	✓	✓	✗	✗	✗	
Luxembourg	✗	✓	✗	✗	✗	
Mexico	✓	✓	✗	✓	✓	Uses markers in the budget to track child related spending.
Netherlands	✗	✓	✗	✗	✗	
New Zealand	✓	✓	✓	✗	✗	
Norway	✓	✓	✗	✗	✗	
Poland	✗	✗	✗	✗	✗	
Portugal	✓	✓	✗	✗	✗	Developing approach to green budgeting.
Slovak Republic	✗	✓	✗	✗	✗	
Slovenia	✗	✗	✗	✗	✗	
Spain	✓	✓	✗	✓	✓	
Sweden	✓	✓	✗	✗	✗	
Switzerland	✗	✓	✗	✗	✗	
Türkiye	✓	✓	✗	✗	✗	
United Kingdom	✗	✓	✗	✗	✗	
United States	✗	✗	✗	✗	✗	

Symbol	Meaning
✓	Implemented
✓	Currently developing or in the process of implementing
✗	Not implemented

Source: Developed by the OECD (2023).

Note: Information on gender budgeting is sourced from the 2022 OECD Survey on Gender Budgeting and information on green budgeting is sourced from the 2022 OECD Survey on Green Budgeting. Information regarding other strategic budget initiatives is sourced from personal correspondence with senior budget officials in OECD member countries.

Although the implementation of strategic budget initiatives is becoming increasingly common across OECD countries, there is still a handful of countries which do not have any in place (Costa Rica, Czechia, Estonia, Hungary, Latvia, Poland, Slovenia and the United States). Some of these countries are considering the

introduction of strategic budget initiatives and are in the process of developing an approach (e.g. Costa Rica, Latvia, Slovenia and Hungary). Others may have budgeting practices that have similar objectives to strategic budget initiatives, but that they do not define as such. For example, in the United States the President's Budget has become an important tool of the equality agenda, with the most recent President's Budget in March 2023 including several strategic policies for advancing the position of women nationally and internationally (The White House, 2023^[6]).

Preliminary observations regarding strategic budget initiatives

With the increasing prevalence of strategic budget initiatives as a budgeting tool, this section presents some preliminary observations related to their introduction, application, and sustainability across OECD countries. These observations are based on the work of the OECD Network on Gender Budgeting, a series of interviews with countries that employ multiple strategic budget initiatives, and data from recent surveys, including the 2022 OECD Survey on Gender Budgeting and the 2022 OECD Survey on Green Budgeting.

Gender budgeting has served as a 'trailblazer' for other strategic budget initiatives

Gender budgeting often served as the pioneering strategic budget initiative for OECD countries. This paved the way for the adoption of other strategic budget initiatives, both within individual countries and across the broader OECD community. This trend is evident in countries like Austria, Canada, Ireland, and Spain, where gender budgeting preceded the introduction of other initiatives like green budgeting and well-being budgeting. In essence, gender budgeting has been a 'trailblazer', laying the groundwork for the introduction of these other initiatives (as illustrated in Box 1 for Ireland). It has achieved this by demonstrating the effectiveness of a new tool that can be utilised to foster a whole-of-government approach to addressing specific cross-cutting priorities. Moreover, given that gender budgeting gained prominence during a period of growing recognition for the need for comprehensive policy responses to climate change, green budgeting emerged as a natural successor.

Although gender budgeting has been the forerunner strategic budget initiative in many OECD countries until now, there is no necessity to introduce it before others. However, introducing a single strategic budget initiative at time can be beneficial in developing knowledge and capacity over time, and preventing government officials involved in implementing these initiatives from becoming overwhelmed.

Box 1. Example of gender budgeting paving the way for other strategic budget initiatives in Ireland

The Government of Ireland announced that it would introduce equality budgeting on a pilot basis as part of a commitment in the 2016 Programme for a Partnership Government to “develop the process of budget and policy proofing as a means of advancing equality, reducing poverty and strengthening economic and social rights”. Initially, gender was the primary axis of the equality budgeting effort, but the initiative has been incrementally extended to include other equality dimensions. In 2018, the government committed to the progressive introduction of green budgeting. Its introduction was a recognition of the need to reform policy frameworks and financial flows to achieve a low carbon transition. The goal of green budgeting in Ireland is to promote and achieve improved environmental outcomes through the budgetary and estimates process. The 2020 Programme for Government outlined the intention to develop new measures of well-being and included a dashboard designed to inform the budget process.

Source: OECD, Integrated Performance Budgeting Framework: Technical Note, 2022.

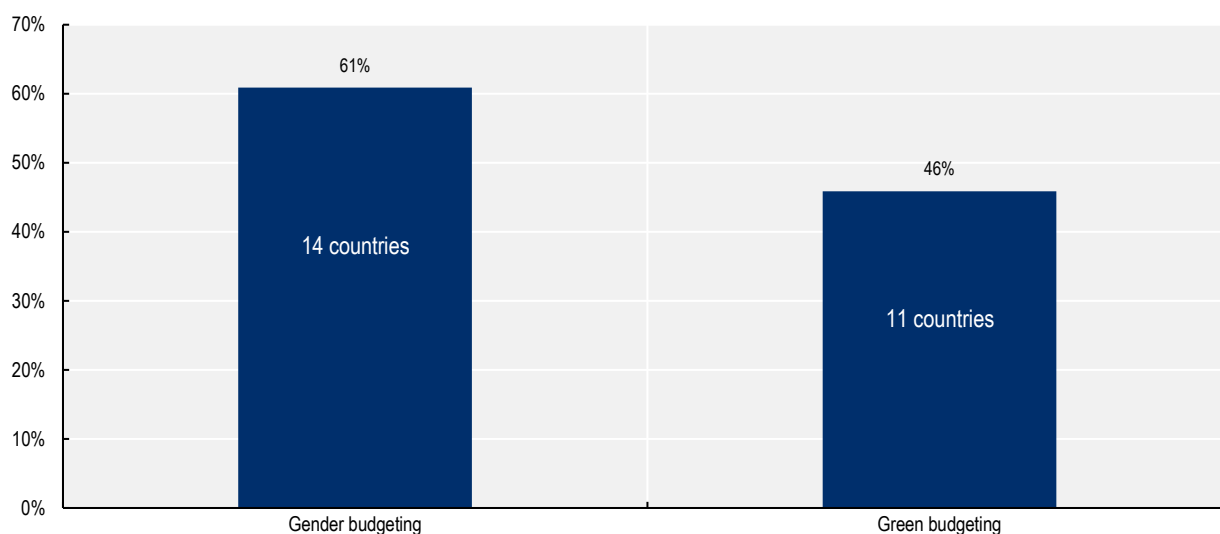
The implementation of strategic budget initiatives varies from superficial to deep-seated

The depth of implementation of strategic budget initiatives varies considerably, ranging from superficial to deeply ingrained. Given limited administrative resources, governments inevitably prioritise certain initiatives over others, leading to disparities in implementation speed, resource allocation, and overall commitment. Political backing, legal underpinning and strong leadership from the central budget authority are all elements that are key to more successful and in-depth implementation.

The influence of political backing on the implementation and relative prioritisation of strategic budget initiatives is demonstrated in France's experience. Strong political support for green budgeting under President Macron has helped fast-track its implementation in recent years relative to gender budgeting. When political backing is weak, the implementation of strategic budget initiatives becomes challenging.

Given the importance of legal underpinning in facilitating more in-depth implementation of strategic budget initiatives, it is interesting to note that legal footing is more prevalent for gender budgeting relative to green budgeting (see Figure 9). This may reflect the relative maturity of gender budgeting and gender equality as a policy priority compared to climate action. Consequently, some OECD countries observe that gender budgeting is implemented with greater consistency and seriousness compared to those initiatives without legal backing. It will be useful to observe in the coming years whether initiatives with legal underpinning will also exhibit greater longevity and resilience.

Figure 9. Percentage of strategic budget initiatives with legal underpinning in the OECD, 2022



Source: OECD analysis based on 2022 OECD Survey on Gender Budgeting (OECD, 2023^[41]), 2022 OECD Survey on Green Budgeting (forthcoming)

Note: Legal underpinning includes initiatives underpinned by constitution, organic budget law or other legislation.

To effectively manage strategic budget initiatives, central budget authorities may need to take on new roles and acquire new competencies

Any budget reform brings challenges in terms of developing the capabilities and capacities for implementation. Successful implementation relies on training and capacity development, and financial resources to support implementation. There is evidence to suggest that this is not always fully recognised when governments adopt new strategic budget initiatives. OECD countries report lack of resources (e.g. time, staff) and lack of relevant technical knowledge and expertise as the two most pressing challenges in relation to the implementation of both gender budgeting and green budgeting (OECD, 2023^[41]) and (OECD,

2023⁽⁵⁾). The implementation of these new initiatives may in some cases require a change in culture and mind-set that depends on both high-level political support and long-term effort.

Strategic budget initiatives often necessitate policy expertise in areas beyond the traditional purview of the central budget authority (CBA), such as gender equality or climate change. Fostering collaboration between the CBA and policy experts can be helpful in addressing this challenge. These may be policy experts across government, such as central gender equality institutions or ministries of environment. Non-governmental organisations (NGOs) at national and regional levels can also play a pivotal role in capacity-building. Collaboration could include input into training programs or the provision of constructive feedback on analysis conducted as part of strategic budgeting exercises.

When multiple strategic budget initiatives are in place, the CBA can play a crucial role in mitigating ‘lens competition’, a phenomenon where different initiatives vie for attention and resources, potentially hindering their overall effectiveness. At their core, strategic budget initiatives aim to enhance decision-making by analysing the impact of budget measures on various social, economic, and environmental dimensions. They promote greater analytical rigor in policymaking and encourage evidence-based decision-making across the budget process. Additionally, they foster alignment between budgetary choices and overarching government priorities. In this sense, multiple initiatives should ideally be mutually reinforcing. Progress in one area should help pull up – rather than compromise – progress in others.

Despite the potential common benefits, the coexistence of multiple strategic budget initiatives does in some cases lead to lens competition. It can also manifest in demands for the introduction of new strategic budget initiatives, with stakeholders seeking to have their own ‘lens’ represented in the budgetary process.

The possibility of lens competition arising from multiple strategic budget initiatives and the need to manage it are among the compelling reasons for having these initiatives centrally led by the CBA, which is indeed the norm in most OECD countries. Centralising the responsibility for strategic budget initiatives under the CBA, the body responsible for coordinating budgetary decisions, can effectively prevent clashes between stakeholders seeking to promote their respective policy priorities. The CBA's comprehensive overview of the budget enables it to evaluate proposals, identify synergies, and allocate resources strategically. Additionally, by assuming a central role, the CBA can foster collaboration among different departments, breaking down siloed thinking and promoting a more holistic approach to budgeting.

CBAs in OECD countries are employing various strategies to mitigate the impact of lens competition. This includes harmonising the treatment and reporting of information and analysis across different strategic budget initiatives. Additionally, emphasising transparent and consistent communication about budget priorities and strategic initiatives is paramount. By openly sharing information, government agencies can align their efforts with overarching government priorities, avoiding unnecessary competition. Transparency fosters collaboration and enables stakeholders to comprehend the underlying rationale behind budget decisions.

Strategic budget initiatives depend on diverse tools and methods to assess the impact of budgetary measures on policy priorities, with some tools being specific to each initiative and others being common across various initiatives

Strategic budget initiatives employ various methods and tools to effectively gather and analyse information regarding the impact of budget measures on diverse policy priorities. Some tools are also only applicable for certain initiatives. For instance, tools such as carbon pricing and carbon budgeting are only relevant to green budgeting. To showcase this diversity, Table 5 presents the most common tools employed by OECD countries in implementing gender budgeting and green budgeting.

Table 5. Most common tools used in gender budgeting and green budgeting across OECD countries, 2022

Gender budgeting			Green budgeting	
	Tool	% of countries	Tool	% of countries
1	Gender dimension in performance setting	52%	Carbon pricing instruments	92%
2	Ex ante gender impact assessment	48%	Environmental impact assessments	75%
3	Gender budget tagging	43%	Sovereign green bonds	75%
4	Ex post gender impact assessment	43%	Green budget tagging	54%
5	Gender impact assessment of budget	39%	Review of harmful expenditures	50%
6	Distributional assessment of tax and welfare measures by gender	35%	Environmental cost benefit analysis	46%
7	Gender dimension to evaluation or performance audit	30%	Green in multi-annual budgets	33%
8	Gender dimension in spending reviews	13%	Green perspective in spending review	25%
9			Carbon budget	21%

Source: 2022 OECD Survey on Gender Budgeting (OECD, 2023^[4]), 2022 OECD Survey on Green Budgeting (forthcoming)

Due to the diverse array of tools applicable to different strategic budget initiatives, it is not uncommon to observe varying approaches to each initiative within a single country (see Box 2 for the example of Austria). Even with centralised leadership and coordination, approaches may diverge due to varying information needs and the uneven advancement of analytical capabilities across different areas. For instance, gender impact assessment may be seamlessly integrated into the policy development process in a given country, facilitating its use in gender budgeting. Conversely, the implementation of environmental impact assessment may be less widespread, leading to the introduction of a different approach to green budgeting.

Box 2. Differing approaches to strategic budget initiatives in Austria

Gender budgeting was introduced in Austria in 2013 as part of a broader budget reform introducing performance budgeting. Gender equality is an important aspect of the performance management system. Of the five performance objectives in each budget chapter, at least one of these objectives must relate to gender equality. Reporting on the gender-related objectives is covered in the Performance Reports prepared by the Federal Performance Management Office.

By contrast, a key tool of green budgeting in Austria is climate-related spending review, introduced in 2021. The long-term goal is to conduct an overall systematic analysis of all the sovereign activities of the federal government and to examine their compatibility with climate change mitigation and environmental protection. The process consists of five modules, the first of which analyses the subsidy and incentive landscape with regard to climate and energy policies.

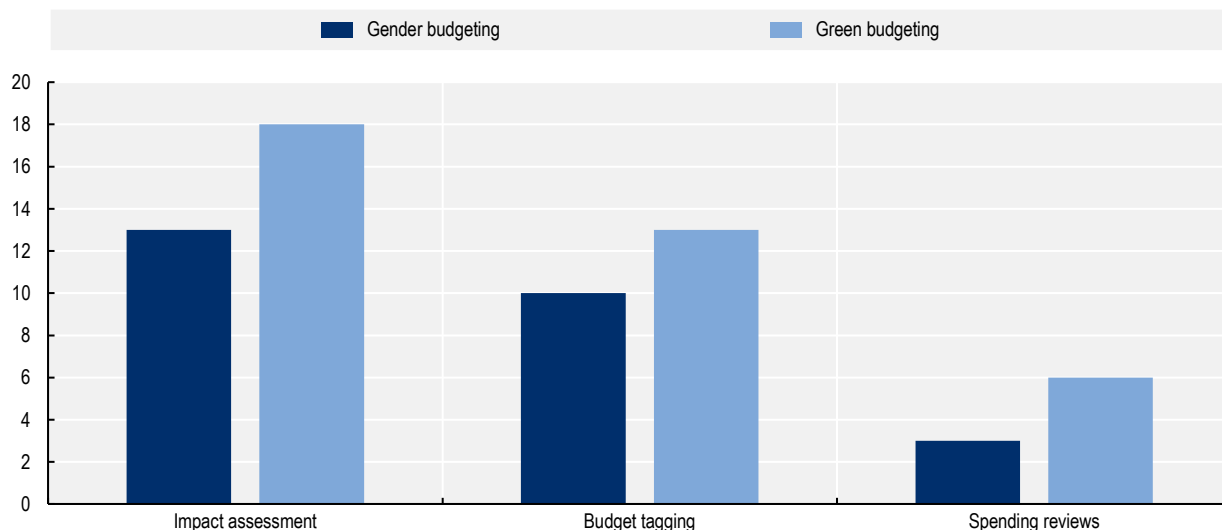
Sources: (Downes, von Trapp and Jansen, 2018^[7]) and (Austrian Federal Ministry of Finance, 2023^[8])

Despite the heterogeneity of approach, some methods and tools are common to both gender budgeting and green budgeting (see Figure 10). This includes:

- **Impact assessments:** This analysis aims to identify the consequences of implementing specific budgetary measures. They go beyond financial considerations and explore broader effects on society, the economy, and the environment.

- **Budget tagging:** Tagging involves categorising budget revenues and expenditures in relation to their purpose or impact. It allows governments to track expenditure contributing to specific objectives.
- **Spending reviews:** Spending reviews are used to systematically analyse the government's existing expenditure. They are a tool to better-manage the aggregate level of expenditure and improve the effectiveness of programmes and policies. They can also help align expenditure according to policy priorities, including social or environmental objectives.

Figure 10. Common tools across different strategic budget initiatives in the OECD, 2022



Source: OECD analysis based on 2022 OECD Survey on Gender Budgeting (OECD, 2023^[9]), 2022 OECD Survey on Green Budgeting (forthcoming)

Note: Count includes either ex ante or ex post impact assessment

Given the central role of impact assessment in many strategic budget initiatives, strengthening the government's capacity to conduct this type of analysis is likely to bolster the implementation of strategic budget initiatives overall. Such efforts can enhance understanding of how to identify the broader social and environmental impacts of policy and budget choices and foster broader awareness of the data requirements for effective assessment.

It is noteworthy that strategic budget initiatives with a narrower range of priorities (e.g. gender budgeting and green budgeting) tend to employ different tools compared to those with multiple objectives (e.g. well-being budgeting or SDG budgeting). This difference is likely attributed to practical considerations. For instance, in-depth impact assessments can be more readily applied to initiatives with a specific set of policy priorities. It becomes more challenging to mandate in-depth impact assessments for strategic budget initiatives with multiple objectives. Alternatively, some countries are developing indicator frameworks that monitor progress against a range of high-level priorities and utilise this information to guide budget (re)prioritisation.

The emergence of strategic budget initiatives has sparked a rise in themed budget statements

With the rise of strategic budget initiatives, there has been the emergence of themed budget statements – such as gender budget statements or climate statements – accompanying the budget in OECD countries

(see Box 3 for the example of Spain). These statements aim to enhance transparency regarding how the budget is being used to advance cross-cutting priorities, thereby strengthening accountability and fostering trust between the government and the public.

Despite the proliferation of themed budget statements, their consideration by parliament and other external stakeholders remains limited. Assessments of OECD gender budgeting and green budgeting practices reveals that countries generally score low in relation to accountability and transparency dimensions (OECD, 2023^[10]). For instance, only 39% of OECD countries practising gender budgeting hold parliamentary committee hearings or debates on the topic (OECD, 2023^[4]). To maximise the impact and influence of these statements, it is crucial to present the information in an accessible manner and to provide a dedicated forum for their examination in parliament and its relevant committees.

Box 3. Cross-cutting budget reports in Spain

The Spanish Government publishes “cross-cutting budget reports” to provide more transparent data and information of specific public expenditures in relation to certain cross-cutting policy objectives and aims.

One of the principal purposes of the cross-cutting reports is to bring the budget closer to civil society, not limiting it to being exclusively financial and in turn making it more accessible. Cross-cutting information also contributes to strengthening the budgetary formulation process, improving the quality of budget information and thus promoting fiscal transparency and accountability.

The number of cross-cutting reports produced alongside the budget in Spain has increased over time. Work on the initial cross-cutting report relating to the gender impacts of the budget began in 2008. A child, adolescent and family impact report and an SDG alignment report were both introduced in 2021. The first report on the alignment of the budget with the green transition was published in 2023.

Source: (Government of Spain, 2023^[11]).

Governments are exploring methods to align and interconnect multiple strategic budget initiatives and the role of digital tools

Several OECD countries are actively exploring strategies to enhance the coherence and effectiveness of their multiple strategic budget initiatives. The incremental addition of these initiatives over time has resulted in a situation where multiple initiatives now coexist in some countries. However, these initiatives have largely been designed and implemented independently, often leading to the existence of separate guidelines, analytical tools, and themed budget statements. While the proliferation of strategic budget initiatives is intended to positively impact public policy outcomes, the haphazard introduction of multiple initiatives without careful consideration of their interrelationships risks overburdening government administrations.

It is crucial that any holistic framework for multiple strategic budget initiatives effectively conveys both the distinct and shared objectives of each initiative. Such a framework holds the potential to ensure that these initiatives collectively enhance the outcome-oriented nature of budgeting and forge stronger linkages between cross-cutting government priorities and the budget process. Canada is an example of a country that has already delved into how its strategic budget initiatives (well-being/quality of life budgeting and gender budgeting) can mutually reinforce each other (see Box 4).

A prevailing concern is that the continued expansion of multiple strategic budget initiatives within a single country could erode the core purpose of these initiatives, which is to concentrate efforts on advancing one or more cross-cutting policy priorities. If too many strategic budget initiatives are introduced, the concept of prioritisation could become diluted, leading to a scenario where everything becomes a priority. As the

saying goes, "when everything is a priority, nothing is a priority." This raises questions about the eventual trajectory of strategic budget initiatives and the point at which multiple initiatives transform into something altogether distinct.

Box 4. An integrated approach to well-being/quality of life and gender budgeting in Canada

The Canadian federal government has introduced a [Quality of Life Framework](#) which tracks well-being and aims at supporting inclusive and sustainable growth. Drawing on the evidence of what makes for a good quality of life, the Framework is composed of five interrelated domains – prosperity, health, society, good governance, and environment. The Framework is about measuring what matters most to Canadians through a suite of 84 indicators that take a holistic view of societal progress.

The Framework also has two cross-cutting lenses, the fairness and inclusion lens, and the sustainability and resilience lens. The fairness and inclusion lens is intended to inform policy and programme development, leading to greater equity and equality. The fairness and inclusion lens was developed based on Canada's experience with Gender-Based Analysis Plus (GBA Plus) and gender budgeting. GBA Plus ensures that the federal government has a gender and diversity-sensitive approach to the policy-making process, so that it understands who is impacted by its policies and mitigates unintended consequences that perpetuate existing inequities.

Taken as whole, the Framework provides a structured means for the government to think in an integrated, inclusive, and long-term way about how its decisions impact the lives of Canadians. The Framework is about measuring what matters most to Canadians through a suite of 84 indicators that take a holistic view of societal progress.

The government is committed to applying GBA Plus and Quality of Life indicators in decision making, to ensure that policies and programmes consider impacts on people from a variety of perspectives. Gender budgeting demonstrates how an inclusion lens can be incorporated into the budget decision-making process and into the budget itself, and as a cross-cutting component of the Quality of Life Framework. The Fairness and Inclusion lens is intended to promote greater equity and equality by assessing the distribution of all outcomes across different populations and building on the base already established by GBA Plus.

Results of this analysis are published as an annex to the budget, in the Budget Impacts Report. For example, in the Budget 2023 Impacts Report, for each budget measure, information is provided on the key impacts of the measure from a gender and diversity and quality of life perspective, including direct and indirect impacts, both positive and negative. Details include:

- Quality of Life Impacts: the domains of the Framework that each budget measure is expected to advance, and relevant indicators.
- Expected Benefits – Gender: information on the expected gender characteristics of the benefitting group, ranging from predominantly men to predominantly women.
- Gender Results Framework (if applicable): the goal or objective that each measure is expected to advance within Canada's Gender Results Framework.
- GBA Plus Responsive Approach (if applicable): any effort in place to minimise possible negative impacts of a measure on certain individuals or groups, or any specific design elements which have been incorporated to reduce potential barriers to participation or access that a certain group may face.

Source: Government of Canada (2022^[12]), 2023 Budget: Statement and Impacts Report on Gender, Diversity, and Quality of Life, <https://www.budget.canada.ca/2023/report-rapport/gdql-egdqy-01-en.html> and Quality of Life Hub, <https://www160.statcan.gc.ca/index-eng.htm>

Specially developed IT systems are proving to be valuable assets for countries in managing and automating the increased information flows associated with strategic budget initiatives. These systems offer the opportunity to streamline and automate the collection of information on the impacts of budget measures, thereby helping to minimise the resource implications of strategic budget initiatives, particularly multiple initiatives, for departments and agencies. They can also assist in synthesising the collected information, facilitating and even automating reporting for the CBA. These types of tools are currently being developed and implemented in several OECD countries, including Iceland and Ireland (see Box 5).

Box 5. Digital solutions to support multiple strategic budget initiatives in Iceland and Ireland

Iceland

In the context of implementing performance budgeting, SDG budgeting and gender budgeting, Iceland is undergoing revisions to its central budget system and developing a tailor-made IT system with a tagging module. The aim is that during the budget preparation process, ministries identify how each area of expenditure is related to a government priority (e.g., SDGs, gender specific targets). This will enable the Ministry of Finance and Economic Affairs to aggregate information and assess overall links between the budget and different crosscutting priorities.

In the same IT system, the budget submission form currently includes a field for the result of a gender impact assessment (GIA), where line ministries can choose between the following options: “Not assessed”, “Promotes gender equality”, “Maintains *status quo*” or “Increases gender inequality/gender gap”.

Exporting the data from the budgeting system facilitates further analysis, where statistics can easily be generated, for example, on the percentage of measures accompanied by a GIA or percentage of measures that promote gender equality. This can both be done by number of measures or value of measures. The results of the analysis are provided to the Ministerial Committee on Public Finances and subsequently the Cabinet, providing high-level summary information on GIAs to inform final budget decision making. Results are also published in the Budget Bill along with a summary of key findings from the GIAs.

Ireland

Ireland has been actively reforming its budgetary system in recent decades and strengthening its performance orientation by introducing performance budgeting, and more recently green budgeting and equality budgeting. Well-being budgeting is also being considered. As a next step, Ireland intends to use budget tagging to consolidate different information into the existing framework and give greater visibility around budgetary commitments linked to cross-cutting priorities. To facilitate this, Ireland is adding tagging functionality to its “e-estimates” IT system. Functionalities being considered include:

- Linking assigned tags to the existing performance targets and budget lines.
- Aggregating information tagged under sub-tags (e.g., SDG 5) into the high-level tags (i.e., green, equality, well-being, and SDGs).
- The provision of summary information in dashboards that include various filters to allow for analysis of information from different angles.
- The ability to enter comments to document the rationale for any changes.

Source: Developed by the OECD (2023).

The information gathered and compiled through these digital solutions could also become instrumental in supporting the evaluation of strategic budget initiatives - a pressing challenge that remains unresolved. For instance, in Austria, where gender budgeting has been implemented for over a decade, a recent study examined gender impact assessments and audit reports to determine whether or not the scope of gender budgeting had expanded over time and whether or not there had been a substantial increase in gender-related policy measures supported by gender budgeting analysis (Polzer, 2020^[13]).

As many strategic budget initiatives are still relatively new, it remains to be seen if they can achieve their intended outcomes and whether they will be able to withstand political change

For strategic budget initiatives to remain relevant and sustainable over time, they must demonstrate their practical value to stakeholders across the political, administrative, and civil society spheres.

Although the adoption of strategic budget initiatives has gained traction, much remains to be learned about the underlying factors that contribute to effective practices with tangible outcomes. This, coupled with the close connection between strategic budget initiatives and political priorities, raises concerns about the likelihood of these practices fading in and out of prominence with shifts in government leadership. The experience of Australia with gender budgeting – initially introduced in the 1980s, discontinued in 2014, and reintroduced in 2018 – highlights the challenges in maintaining consistent momentum for these initiatives across successive governments. The coming years will be pivotal in determining whether these initiatives can transcend their role as political signalling tools and evolve into mechanisms with meaningful and enduring impacts on budgetary decisions and cross-cutting policy outcomes.

Given the proliferation of strategic budget initiatives in OECD countries in recent years, their resilience in the face of political transitions remains to be tested. When the priorities that these initiatives aim to advance are closely intertwined with the ideological leanings of a particular government, the likelihood of their demise increases. In this dynamic environment, only time will tell whether strategic budget initiatives will endure as a valued and enduring facet of public budgeting.

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OECD performance budgeting framework

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The OECD Performance Budgeting Framework provides four building blocks to guide countries in strengthening their approach to performance budgeting. These are (i) tools and methods for developing meaningful performance information, (ii) accountability and transparency, (iii) a strong enabling environment, and (iv) the use of performance information to inform decisions around the budget.

JEL classification: H61, H11, H50

Keywords: public finance, performance budgeting, performance and results, informing budget decisions

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What is performance budgeting?

Performance budgeting is defined as the systematic use of performance information to inform budget decisions, either as a direct input to budget allocation decisions or as contextual information to inform budget planning. Its purpose is to instil greater transparency and accountability throughout the budget process by providing information to government officials, legislators, and the public on the purposes of spending and the results achieved.

Performance budgeting is part of a wider set of reforms that aim to change the behaviour of key players in the budget process, shifting the focus away from inputs (“how much funding will I receive?”) towards measurable results (“what can be achieved with the funding I received?”). Countries have reported a number of benefits of using performance budgeting, including more efficient allocation of funds and a better understanding of government priorities, as well as greater transparency and accountability throughout the budget process.

There is no one-size-fits-all design to performance budgeting, but based on OECD analysis and country experiences, several factors can facilitate the process of introducing performance budgeting, such as clear, transparent objectives and incentives for major stakeholders, and a practical design of the process.

The OECD classifies different approaches to performance budgeting as follows:

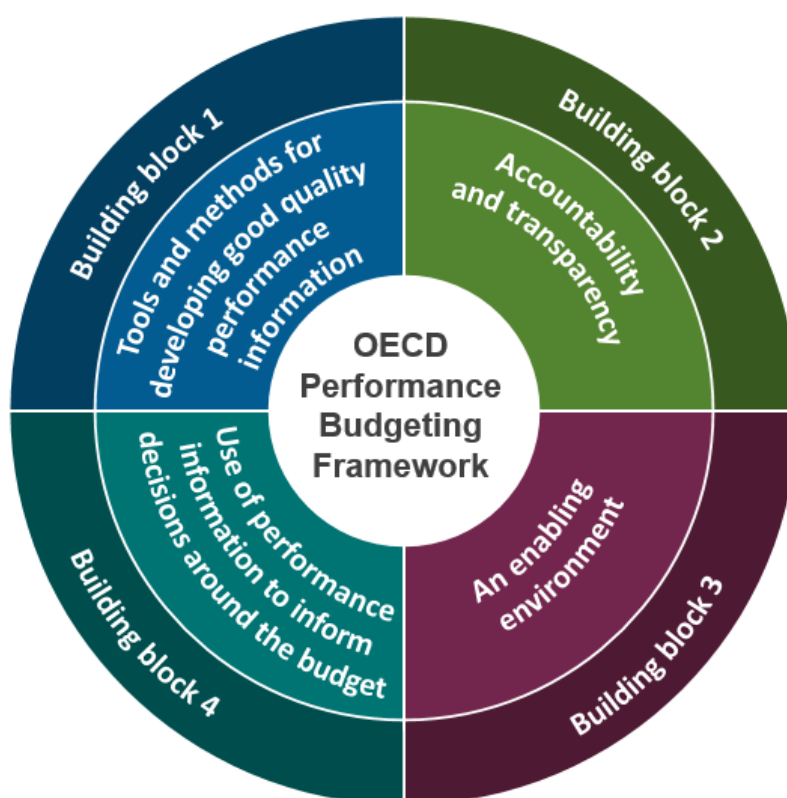
- **Presentational Performance Budgeting** is where performance information (goals, outputs, outcomes, and performance indicators) is shown separately from the main budget document. In this approach, the budget may or may not be structured into programmes. It is commonly the first step in introducing performance budgeting.
- **Performance-Informed Budgeting** is where performance information is included within the budget document alongside financial information structured, typically, into programmes. In this approach, performance information is used to inform budgetary decisions. This is the form of performance budgeting that is commonly used by OECD countries.
- **Managerial Performance Budgeting** is a variant of performance-informed budgeting. With this approach, the focus is on managerial impacts and changes in organisational behaviour, achieved through the combined use of budget and related performance information.
- **Direct Performance Budgeting** is where a direct link between results and resources is established, usually implying contractual-type mechanisms that directly link budget allocations to the achievement of results, with budgetary responses to over or under-achievement of performance objectives. No OECD country identifies itself as using this direct approach.

The OECD Performance Budgeting Framework

The OECD Working Party on Performance and Results meets regularly to discuss developments and share good practices in relation to performance budgeting and other performance-related reforms. The experiences of OECD countries have helped design the OECD Performance Budgeting Framework, which provides building blocks to guide countries in strengthening their approach to performance budgeting.

The OECD Performance Budgeting Framework consists of four building blocks (Figure 11). These are (i) tools and methods for developing meaningful performance information, (ii) accountability and transparency, (iii) a strong enabling environment, and (iv) the use of performance information to inform decisions around the budget.

Figure 11. OECD Performance Budgeting Framework



Building block 1: Tools and methods for developing good quality performance information

High quality information on performance and results is the foundation of performance budgeting. The way performance information is developed has an impact on its relevance and quality; it should be based on the priorities of the government and structured logically, specific criteria for developing the information should be used, and the quality and relevance of the information should be ensured.

Sequencing performance information

Performance information (objectives, indicators, targets, benchmarks) should be structured in a logical and clear manner, where performance indicators clearly measure the progress towards achieving certain performance objectives. Performance information should be benchmarked towards high-level objectives that reflect the priorities of the government.

Avoiding overload of information

Setting a limit on the number of performance objectives and indicators is necessary as it helps to avoid overload of data, which can hinder the usefulness of performance budgeting. While relying on a single performance indicator may not be enough to thoroughly evaluate a program's performance, it is essential to be selective in choosing performance information that is the most relevant and helpful for decision-making.

Criteria for developing performance information

Performance information developed as part of the budget process should clearly demonstrate the outputs and outcomes each programme aims to achieve, and not only describe the activities of a given programme. For example, focusing on tangible results and long-term impacts, such as educational achievements of students rather than detailing the number of schools operated. This output/outcome orientation is fundamental for the success of performance budgeting as it focuses discussions around the budget on the broader benefits for citizens and taxpayers and away from input measures. Having clear and specific criteria (e.g., SMART¹) for performance information helps promote outcome orientation and ensure the usefulness of performance information. Although it is natural that a significant proportion of targets and indicators are revised in the early years of implementing performance budgeting, it is important to ensure consistency of performance information over time.

Quality assurance of performance information

Ensuring good quality of performance information is important for the integrity of the performance budgeting framework. In order to promote autonomy and accountability of spending entities, it is important that they are responsible for the information they produce and present. It is, however, important to have some quality assurance of the performance data that spending entities produce, where the ministry of finance provides guidance and quality checks to ensure that the information in the budget is accurate, of high quality and consistent across entities.

¹ SMART stands for Specific, Measurable, Achievable, Relevant and Time-bound.

Building block 2: Accountability and transparency

When implementing performance budgeting, countries often cite increased accountability and transparency as the main objective for the reforms. However, ensuring accountability and transparency, defining clear roles and responsibilities, and improving scrutiny and public access to performance information require significant effort and time.

Managerial flexibility and accountability

Accountability for the results achieved by spending entities is a key element of a strong performance budgeting framework. In a well-functioning performance budgeting framework, spending entities set ambitious performance targets and are ready to discuss and explain if these targets are not achieved. This should allow spending entities to have higher discretion to allocate funds within their spending ceilings. However, finding an optimal arrangement incorporating managerial flexibility and control can be challenging and take some time to settle.

Strong reporting mechanisms

Creating monitoring mechanisms, such as reporting on performance in annual end-year reports where the same performance targets are presented in the budget and in the end-year reports, may help promote accountability for the results achieved, as well as increase transparency around the performance framework. To ensure effective scrutiny, it is important to align the timeline for performance reporting with that of the budget cycle, where performance reports are presented together with budget execution reports.

Performance budgeting increases transparency around what is achieved with public resources and provides contextual information for parliamentarians and the public. The way performance information is presented and developed has strong implications for the effectiveness of performance budgeting. Although there is no direct link between performance and funding allocations, spending entities should clearly explain why certain targets have not been met and actions to be taken to get back on track. This information should be included in performance reports and be presented to relevant stakeholders.

Roles and responsibilities

In order to promote a result-oriented performance culture across government, clear roles and responsibilities should be established. As shown in Table 6, the ministry of finance plays a key role in co-ordinating performance budgeting across government and is primarily responsible for providing guidance to spending entities on how to develop, collect and report on performance.

Spending entities are accountable for the performance information they develop and co-ordinate with the ministry of finance when setting performance objectives and associated targets to ensure quality and consistency. There must be a relationship of mutual trust between the two bodies for performance budgeting to be effective.

One important role of spending entities involves securing a formal approval or a sign-off by a minister and/or permanent secretary on performance information to be included in the budget. This might limit the risk of performance setting being merely a tick-box exercise that has no real political relevance.

Table 6. Roles of key stakeholders in performance budgeting

Ministry of Finance	Spending entities	Parliament	Audit offices
• Develops the performance budgeting framework. • Develops guidelines for the implementation of performance budgeting. • Develops templates for collecting performance information. • Ensures the consistency. • Analyses what spending entities produce. • Organises capacity-building activities. • Initiates relevant updates to the IT systems.	• Co-ordinates with the finance ministry in setting up programmes and their objectives, developing performance indicators and targets. • Ensures the operational execution of performance budgeting (i.e., monitoring, reporting). • Sets meaningful and relevant indicators that reflect the priorities of the Government. • Ensures high-level sign-off (by a minister, and/or permanent secretary) of performance information to ensure political relevance.	• Oversight and accountability. • Analysing and confirming the budget. • Use performance information for deciding and discussing resource allocation. • Use performance information to hold ministries accountable. • Have discussions with stakeholders to improve the information provided in the budget. • Sectoral committees should play a particular role in reviewing performance budgeting for their portfolios.	• Assesses the structure and soundness of the overall performance framework. • Assesses whether reported information, regarding performance and results, is accurate and substantiated. • Compliance with legal requirements regarding performance information and budgeting.

Public access to performance information

Publishing performance information in an accessible and understandable manner allows the wider public to better understand the achievements of the government. This enhances transparency and can contribute to increased trust in government. Modern information technology can support this effort, including the use of web-based dashboards where performance and outcomes achieved can be compared across entities and different policy areas and tracked overtime.

Building block 3: An enabling environment

Performance budgeting is most effective in settings where there is an enabling environment which supports the implementation of the framework. Elements that enable performance budgeting include programme budgeting, the use of centrally issued guidelines and templates, capacity-building efforts, IT systems and incentive mechanisms.

Budget structured around programmes

A budget structured around programmes facilitates the implementation of performance budgeting where performance objectives, outcomes and outputs are set at the programme level under the responsibility of a single programme manager. A budget structured around programmes can pave the way to delegate more responsibility to spending entities for managing programmes and budget execution, which is a pivotal part of performance budgeting.

A programme classification of the budget closely follows the organisational structure of a ministry, where a programme manager is responsible for a single programme and there are no overlapping responsibilities. Countries that have introduced programme budgeting usually stay close to the existing organisational structure in the initial stages of the reforms, but once the programme classification is in place, certain changes in the organisational structure and division of tasks between ministries can take place.

Centrally issued guidelines and templates

It is important that finance ministries provide guidance to spending entities when implementing performance budgeting. This can be included in budget circulars, or through specific manuals and templates. The use of standardised templates ensures that all ministries follow the same principles when putting forth performance information, as well as ensuring consistency and readability of the documents. Leaflets and other educational materials can also be provided to parliament and other relevant stakeholders to keep them informed of the progress of the reform and ensure that the key terms and concepts are well understood across the administration. Any changes to the overall performance framework, templates and other elements should be communicated to relevant stakeholders.

Capacity-building efforts

Performance budgeting entails new responsibilities for all involved stakeholders and thus requires new skills and competencies. Capacity-building efforts in the form of training sessions, peer workshops, and performance budgeting schools help build strong analytical skills within administrations. These efforts should not be a one-off exercise but organised regularly; creating a new mind-set and a performance culture within public administration requires persistent efforts.

Supporting IT environment

A well-designed IT system can be a central support tool for public financial management reforms. IT systems that integrate both financial and performance information allows for seamless tracking of information over time, and for extracting relevant reports. These reports can be provided upon request to the government, parliamentarians, and other key stakeholders in an organised manner.

Incentive mechanisms

A strong link between performance information and financial consequences undermines the purpose of performance budgeting, however, the right incentives are key to encouraging ministries to embrace performance budgeting initiatives, set ambitious and relevant goals and be accountable for the results achieved. Having incentives in place is especially important in the early years of implementing performance budgeting, when spending entities are gaining understanding of the reforms and may be reluctant to change the traditional ways of budgeting. One way to incentivise spending entities is to identify champions within the administration to set a good example for other ministries. These champions may be granted greater flexibility and increased control over programmes providing additional incentives for other ministries to adhere to reforms.

Building Block 4: Use of performance information to inform decisions around budget

One of the major challenges when implementing performance budgeting is the actual use of performance information to inform decisions around the budget. As performance budgeting entails new ways of budgeting, it is important to engage with important stakeholders, such as parliamentarians, and improve the presentation of performance information to maximise the relevance and use of such information in the budget decision-making process.

Engaging with parliament

The successful implementation of performance budgeting largely depends on the involvement of key stakeholders. Given the pivotal role of the parliament in the budgetary process and budgetary oversight, their ability to understand and use performance information in budget decision-making is especially important. Legislature's engagement with performance budgeting is crucial to avoid dual budgeting (i.e., when the budget is prepared both on the programme level and on the line-item level but voted on the latter).

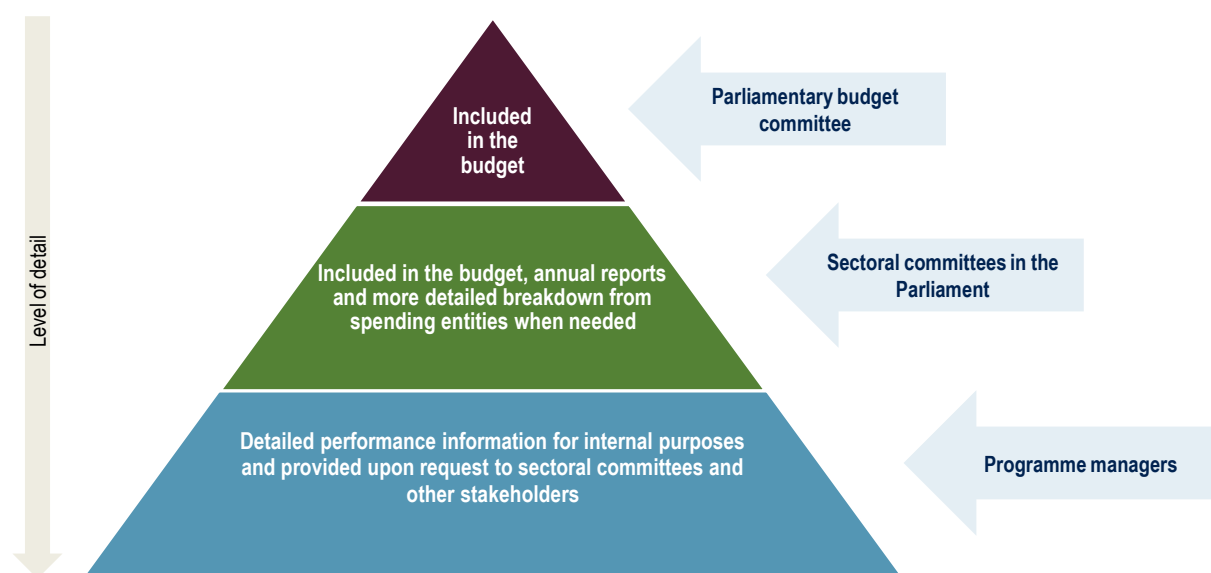
Effectively communicating with parliament, parliamentary budget offices and sectoral committees can improve the impact of performance budgeting. Sectoral committees play a key role in discussing performance information of different spending entities and may engage directly with relevant entities to scrutinise performance information put forth in the budget documentation and reporting documents.

Some parliamentarians might be particularly supportive of performance budgeting, and whenever possible, a discussion should be established with those members of parliament. Having supportive ministries and parliamentarians can be extremely important in improving the use and understanding of performance information.

Presenting relevant performance information in budget documentation

Performance information included in the budget should be presented in a clear and understandable manner alongside financial information. Linking performance information and financial information improves the ability of decision-makers to properly assess the performance of a programme or action and make informed decision. However, it is important to be selective in how and what performance information is presented in budget documentation, as information overload is an inherent feature of many national performance budgeting frameworks. To enable effective scrutiny of performance information, different levels of detail should be presented to different stakeholders, as shown in Figure 2. For example, programme managers need sufficiently detailed information to inform operational decision-making, while parliamentarians, on the other hand, should be provided with performance information relevant to decisions around the budget. Finding the right balance and relevant information to be included in the budget might take time and requires extensive discussions with the stakeholders.

Figure 12. Performance information provided to different stakeholders



Targeting public spending: Means-testing and user charging

Joseph J. Minarik

This paper argues that countries will need to better assess potential savings in the provision of universal benefits and providing services free to all at the point of delivery. Instead, programmes will need to be targeted at those truly in need, and services only free to those with limited ability to pay. It draws an analogy to the progressivity of the tax system where those with greater means pay higher taxes. A similar philosophy should be the basis of government spending. It highlights examples of the application of means-testing and user charging for key areas including retirement benefits, health care and education. The paper is meant to stimulate discussion among Senior Budget Officials.

JEL classification: H11, H21, H42.

Keywords: user fees, means testing, redistribution.

The opinions expressed and arguments employed herein are solely those of the author, written in his personal capacity.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

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Introduction

The once abstract threat of a loss of budgetary control is now becoming real before our eyes.

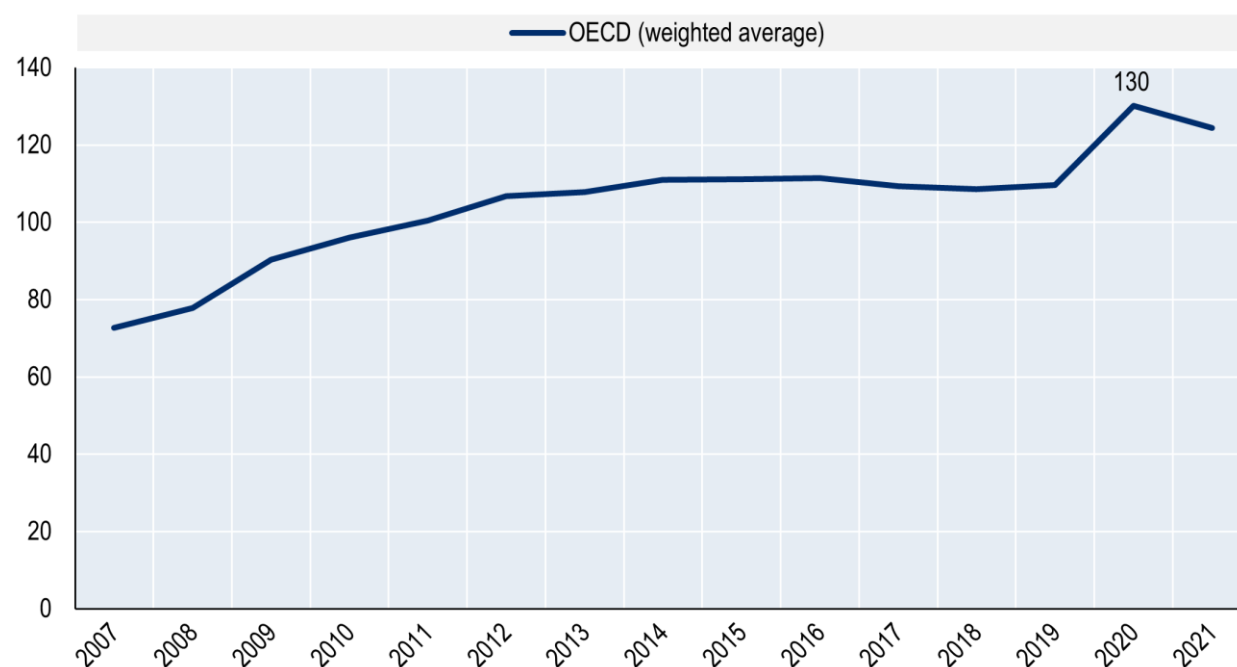
After widespread progress during the robust economic growth of the last years of the 20th century, the fiscal condition of many OECD countries regressed in the first years of this millennium, and was already a cause of concern by 2007. Students of public budgeting concluded that the developed nations needed to shore up their finances to prevent a painful build-up of debt along with resulting crippling debt-service costs that would limit long-term public and private investment and inhibit economic growth.

Instead, the global economy encountered a remarkably widespread financial crisis. Different nations responded in different ways and to different degrees, but the common denominator was indisputably to use public budgets to support private demand in the interest of avoiding even further economic downturns and reductions of employment and incomes. This pushed public debt further beyond historical norms.

Then, in 2020, the world was enveloped by a viral pandemic that closed workplaces, fractured goods value chains, and interrupted supply. Once again, economies on the brink of epic downturns demanded fiscal stimulus to forestall the worst, as well as enormous taxpayer investments in public health to address the pandemic directly. So with no feasible short-term alternative, nations borrowed still further. Figure 13 illustrates how the public debt burdens of OECD countries have risen to levels unknown in modern history. As debt is refinanced at higher post-pandemic interest rates, those debt burdens will only grow still further.

Figure 13. General government debt in OECD Countries

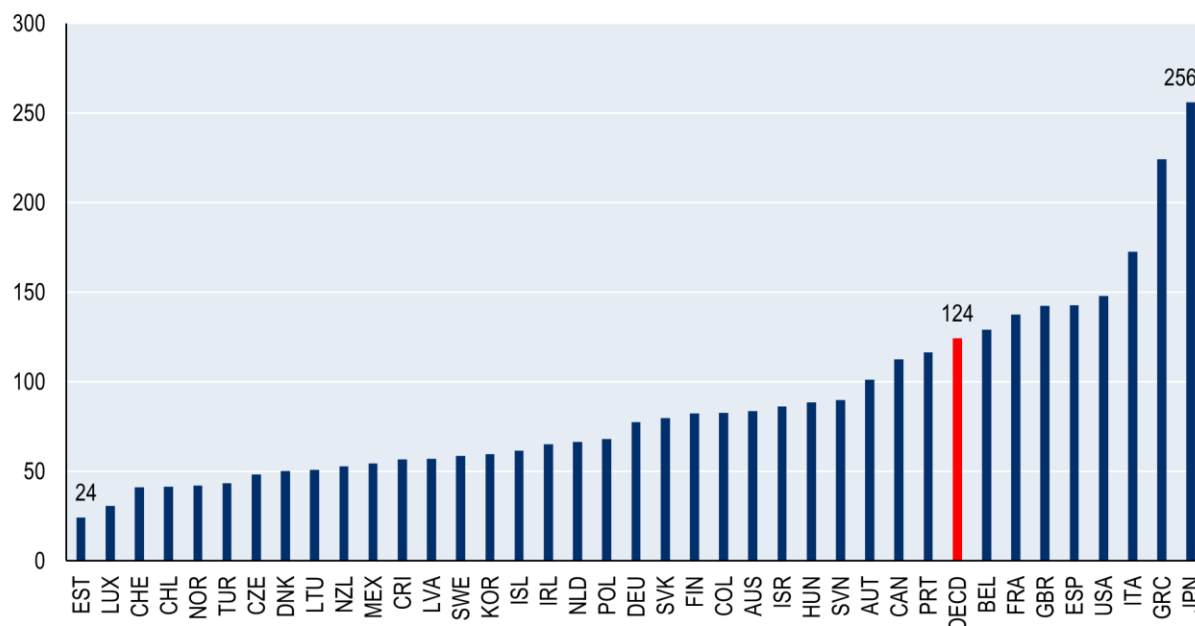
% of GDP, 2007-2021



Source: OECD

Figure 14. General government debt across OECD countries

% of GDP, 2022 or most recent



Note: OECD is the weighted average for 2021. Data for Norway, Canada and Portugal is for 2022. Data for New Zealand and Israel is for 2020. Data for Colombia and Iceland is for 2019. Data for other countries is for 2021.

Source: OECD

Far from demonstrating that “debt doesn’t matter,” these successive episodes of inadequate preparation for monumental bad luck merely set the stage for at least three global experiments. The first is how taxpayer-citizens will react when they realise that the greatest use of their tax moneys is not to buy them security, infrastructure, health care, pensions, or any other public services and amenities, but rather to pay interest on the public debt. The second is how much the disruption of financial markets by a flood of government demand for credit will hamper the economic growth that must support those public budgets. The third is how investors will react when they realise collectively that the sovereign debt that they have forever assumed was riskless may not be riskless after all.

And yet, pressures on public expenditure levels are intensifying even further – because of population ageing, climate change, health care and social care, as well as national security concerns, among many other forces. The scale of these pressures is such that reallocations of funds alone will not solve the problem.

And there is little or no apparent willingness to address the problem head-on, either from politicians as leaders or from the voters themselves. The will to raise taxes is limited, in part because the last two decades of economic dislocation and limited income growth leave citizen-voters unwilling to sacrifice still more for the prospect of avoiding some further ill-defined loss, however potentially serious in the eyes of “experts.” Meanwhile, the capacity of financial systems to accommodate growing debt and deficits is surely not infinite.

So resistance to the conventional fiscal remedies – reductions in public services, and increases in general-revenue taxes – is no less today than it has been over the last 20 years, while debt has mounted faster than the production of even the most technologically adept economies. So, how to get fiscal retrenchment off the dime (or euro, or yen)?

One possibility is to increase the targeting of public spending – that is, to direct public funds more carefully to where they will do the most good. In some programme areas, that might entail asking the citizens who benefit the most from generally accessible public services to pay for them specifically. In other programme areas, public benefits could be targeted more sharply to demonstrated need, by reducing payments to those who are better off.

These two general devices – user fees and means-testing – are a part of government’s toolbox now, but arguably have been less frequently or intensively employed than they could or should be. Before more time passes in inaction, and more debt piles up, it behoves public decision makers to explore the greater potential use of these tools to slow the accumulation of debt across all areas of government operation. Any such moves would not only help to curb the build-up of debt, but also yield the greatest benefit from our increasingly scarce public funds – that is, increasing the “productivity” of government resources.

Applying progressivity principles to spending policies: The rationale, and policy concerns

The term “progressivity” is widely understood as the distributional property of a tax system whose burden rises more than in proportion as income rises. Its rationale rests as much on philosophy as it does on theoretical economics. In the most-abstract theory, economists sometimes reason that the marginal utility of income can be expected to fall as income rises; that is, the first units of income buy the most urgent necessities of life, and thus are most valuable to the recipient; whereas further increases in income purchase nonessentials or even luxuries, and so have less inherent value. If that proposition is accepted, society is made better off – that is, the sum of the “utility” (or well-being) of all citizens is increased – if income is transferred from the most well-off to others who are struggling to keep body and soul together, or at least if proportionally lower taxes are levied on the least well-to-do. However, that proposition is inherently unverifiable. In the end, it is up to society to assess the utility of the first and last units of income through the political process.

The same concept is sometimes applied to analyses of public spending, though less frequently and with less public discussion. Such “progressive spending” might be achieved in two alternative ways. First, the benefits of government cash or in-kind benefits can be reduced as the beneficiary’s income increases; that is referred to as “means testing.” In this way, spending programmes could be more systematically directed toward persons with low incomes. Alternatively, citizens who benefit directly from business-like activities or services of government (which are not specifically targeted toward particular income groups, in one direction or the other) might be required to pay “user fees” in return for the benefits they enjoy.

In several instances, such “progressive spending” might be argued to increase society’s overall well-being. Personal health care for low-income persons, who are less likely to be able to afford it for themselves, might safeguard the broader public health (as the gradual constraint of the long-running pandemic likely demonstrates). At-risk children may contribute more to society and incur fewer social costs if provided with supportive education, adequate nutrition, and safe and secure housing. The same public expenses would have less impact on societal outcomes if directed toward more-affluent households that can and would be expected to provide for their own. Thus, the greatest efficiency in the use of public funds may likely be attained if they are directed more toward need.

Some empirical work has tried to measure a quantitative relationship between progressivity of taxation and rates of aggregate economic growth, though that research is complicated by a mass of other variables, including notably how the direct revenue cost of lower tax rates is financed (Johansson et al., 2008^[1]). An alternative approach is to attempt to measure directly the impact of tax rates on individual behaviour through those incentive effects. Protagonists who are dubious about progressive taxation and spending emphasise the role of price incentives; on their side, highly skilled workers will be discouraged from taking

a job, working longer hours, or accepting more responsibility on the job, if their extra earnings will be taxed more heavily, or if the resulting increment to their ultimate retirement benefits will be smaller (or they would suffer any other reduction of progressive spending – such as reduced subsidies for health care, for example). The other side argues that the effect of more-progressive tax and spending policies will actually elicit more work effort, as those skilled workers seek to replace the resulting lost current spendable incomes and future retirement benefits through greater work or saving. Both of these incentives, referred to in the trade as “substitution” and “income” effects respectively, are at least theoretically real; but they push in opposite directions. And the ultimate question is how they balance in the real world, and how any net negative for economic efficiency in more-progressive tax and spending policies should be weighed against any perceived offsetting positive for equity.

This leaves policy at the horns of the virtually eternal equality-versus-efficiency trade-off (Okun, 2015^[2]). Empirical results are jumbled, to say the least. Over several decades, tax rates have generally (though not monotonically) declined, while work effort has declined as well in the form of earlier retirement – possibly because of greater general societal wealth, a clear “income effect.” Labour force participation declined in the wake of the coronavirus pandemic, but there are signs that participation rates are coming back (Cheung, 2023^[3]).

A philosophical argument is sometimes claimed to resolve the argument for progressivity of both tax and spending policies through a kind of compromise. The proposition is that people not knowing their future life prospects – people somehow placed behind a “veil of ignorance” – would vote for a low-income relief programme financed by moderately progressive taxes. In other words, people behind that veil of ignorance would implicitly choose to purchase insurance through progressive taxes on their higher incomes should they prove to be successful, to finance an improvement of their status through progressive spending if they do not (Rawls, 1999^[4]). Although there is enormous ambiguity, even outright confusion, in public understanding of issues of tax and spending policy, some survey results suggest that this philosophical speculation may roughly accurately represent real-world attitudes (Newport, 2022^[5]; Pew Research Center, 2019^[6]; Schneider and Kahn, 2020^[7]; Barnes, 2023^[8]).

However, there is no veil of ignorance in real life, and imposing means testing through enacted public policy would require the assent of at least some people who already have found themselves successful, and who know that they would pay more with greater means testing. That resistance may or may not be overcome by a large group of modest-income taxpayers voting to increase taxes on the much smaller highly well-off minority to finance more-generous benefit programmes. And we may expect voters to consider the public interest as well as their own personal interests. Thus, although political prospects are always unknowable, the likelihood of adoption of progressive means testing or user fees for fiscal consolidation in the face of mounting debt, with its potentially serious or even catastrophic economic and financial consequences, may nonetheless be greater than that for straightforward tax increases and spending cuts. It could also provide greater efficiency or productivity in the use of public funds at a time when those funds are scarce, and target those funds more closely to need.

With that background in place, the next step will be to review several potential areas for budgetary retrenchment – and government productivity improvement – starting generally with the largest and moving on to the smaller opportunities, some longstanding and some quite new.

Reining in old-age pensions

Any plan to buttress the funding of a national retirement programme in an era of adverse demographic change will be an exercise in means testing. We do not live in the demographically robust world of half a century ago, in which the working-age population and real wages grew continuously at least as fast as the retiree population. All beneficiaries could receive positive rates of return, and strengthening the financing of the system required merely reducing those rates of return fractionally for all. Today, rather, the additional

costs and reduced benefits to compensate for adverse demographic change must be allocated somewhere on a discretionary basis through painful political negotiation and consensus. Therefore, with low birth rates and aging populations, policymakers will be confronted with choices about who pays. Simple across-the-board benefit cuts or tax increases will not pass a political or a perceived-fairness test.

Among the clearest potential applications of means testing are the communitarian programmes such as old-age retirement pensions, which are often thought to require universal participation to maintain social cohesion and broad acceptance. To obtain the revenues needed to maintain social insurance benefits for those whose life earnings outcomes are below the average, it is essential to have upper-income workers contribute – which in turn, given the communitarian rationale, requires that they receive at least some benefit. In many countries, the demographics of rapidly growing workforces in the second half of the 20th century allowed upper-wage workers to receive positive real returns while still subsidising lower-wage workers. Current demographics are not so favourable. Many countries have not yet addressed their own adverse demographic changes, and so their retirement programmes are underfunded. Funding those programmes through more-rigorous means testing would provide an additional benefit in the form of an overall fiscal palliative, and those nations that have not funded their retirement programmes should consider such changes seriously and expeditiously as a first step toward over fiscal sustainability that is essential for those programmes' own viability.

Attaining fuller funding of retirement programmes is of course politically fraught. At a minimum, current retirees must at least be treated with great care, if they are not totally “grandfathered” (i.e. not subject to the new reforms). Similar restraint must be extended to people who are of ages close to typical retirement, because they may have insufficient time to change their retirement plans, or to make work choices to adjust to significant reductions in their expected retirement benefits. The bad news, tellingly, is that even the youngest of the post-World War II baby-boom generations (in those countries that had them) are already very near to customary retirement age. Therefore, financial consolidation of retirement systems will likely prove insufficient without some means testing of affluent current and near-term retirees. The good news is that for all the uncertainty about future demographics and worker and retiree behaviour, retirement programme policies are still far simpler and more precise and predictable in their effects than are health care policies (to be discussed immediately below).

To reiterate, improving the funding of retirement programmes of course pays a double benefit: first, it provides greater certainty for current retirees, and current workers (who are our future retirees); and second, it reduces current and future overall fiscal imbalances – to the benefit of financial predictability and stability, and future economic growth. It is therefore a clear imperative for countries that have not yet funded their programmes for the foreseeable future.

Means Testing of Other Programmes. The universe of prospective means testing surely would not be taken to include pure public goods such as national defence. The benefits of those programmes are intangible and difficult or impossible to value.

However, there are other appropriate uses of means testing. Some narrowly based programmes such as veterans or agricultural benefits are sometimes more generous to comparatively well-to-do beneficiaries than other broad low-income means-tested programmes. Other potential applications of means testing in existing low-income and categorical benefit programmes should also be identified. All such programmes might well be considered for additional, more-rigorous means testing, and the pain of tightening of these benefits must be weighed against inevitable alternative methods of fiscal consolidation.

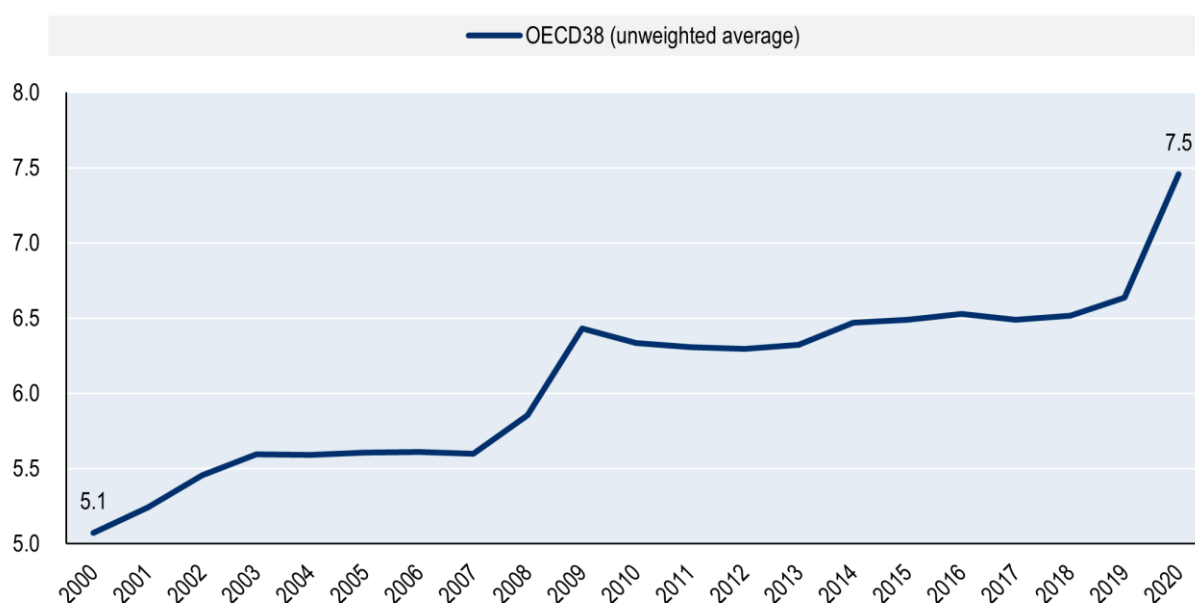
To summarise, the largest benefits potentially subject to means testing are the major national retirement programmes, and bringing those programmes closer to long-term actuarial balance should be a public priority in any event. Other categorical (as opposed to income-based) programmes should at least be considered as well. More-rigorous means testing of income-conditioned programmes should of course be considered, but will be controversial and hotly contested.

Controlling healthcare cost

Health care is a major – perhaps *the* major – cost driver of government budgets today. Although levels of health expenditures as shares of national economies differ across countries, they are rising (potentially unsustainably) in all countries – a trend which long predates the pandemic (see Figure 15). Viewed simply as an arithmetic exercise, it seems clear that the growth of health care costs must be slowed or government budgets will not survive; even if non-health care spending budgets were altered radically, taxes still would need to rise continuously. This is of course not to deny the need of the population for quality care; it is merely to assert the challenge of actually delivering it.

Figure 15. Government spending on health is increasing

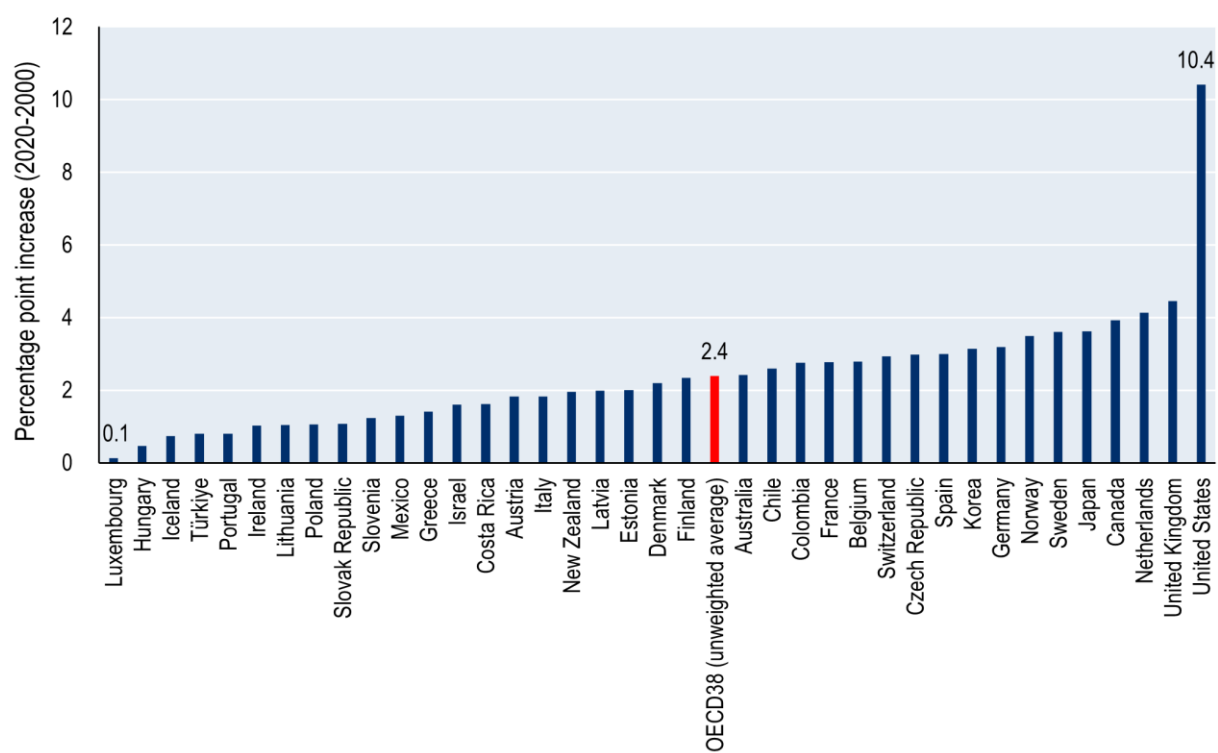
% of GDP, 2000-2021



Note: Includes financing from government schemes and compulsory contributory health insurance schemes. OECD38 is an unweighted average.
Source: OECD Health Statistics (2023)

Figure 16. Increase in government spending on health from 2000 to 2020

Percentage point increase (% of GDP), 2000 to 2020

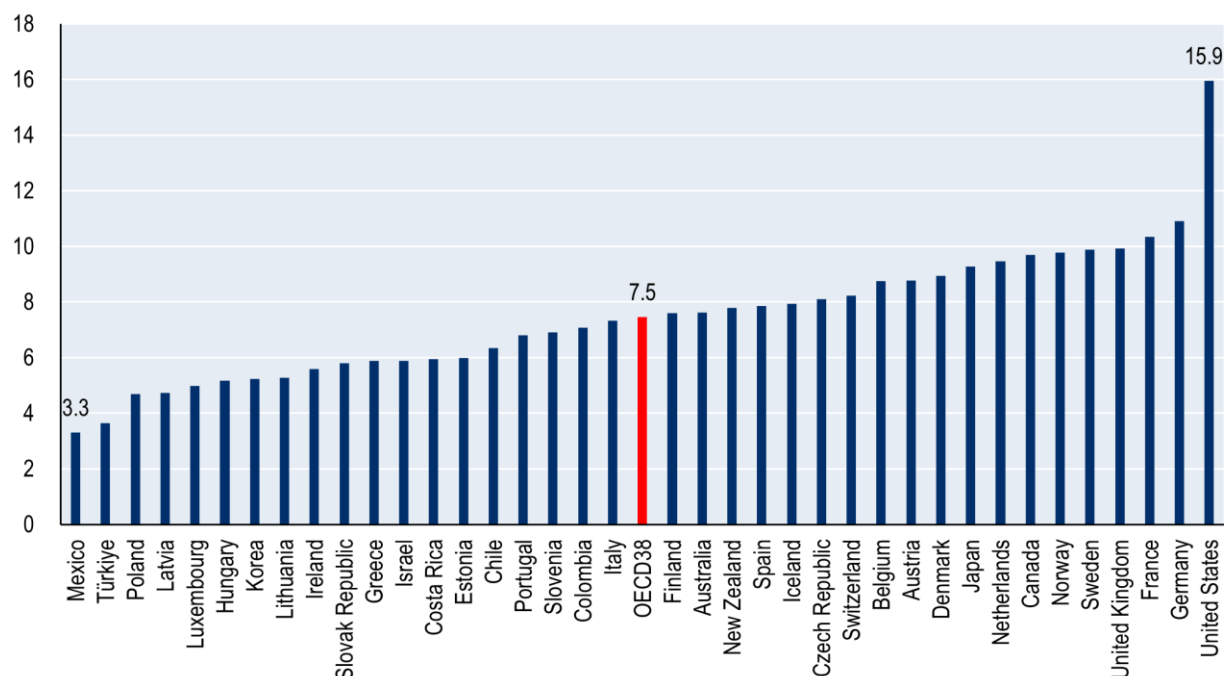


Note: Includes financing from government schemes and compulsory contributory health insurance schemes. OECD38 is an unweighted average.

Source: OECD Health Statistics (2023)

Figure 17. Government spending on health in OECD countries in 2020

% of GDP, 2020



Source: OECD Health Statistics (2023)

Note: Includes financing from government schemes and compulsory contributory health insurance schemes. OECD38 is an unweighted average.

Rising health care spending must be understood in context. There is a logic to people choosing to spend rising shares of their increasing incomes on their health, instead of on larger houses or cars or meals, or richer clothing (Cutler, 2004^[9]). From this perspective, economists would describe health care as a “superior good” – on which people spend an increasing proportion of their incomes as those incomes rise. Such an upward trend in health care spending would not necessarily grow exponentially without limit, and could in time burn itself out. However, even such assessments of trends in health care spending acknowledge that spending grows because of inefficiency as well, and that the cost of delivering one unit of health care at constant quality is in fact growing faster than incomes in the economy as a whole – which cannot be sustained.

Yet another driver of aggregate health care costs is neither reversible nor even in most respects undesirable, and that is the generally lengthening lifespans of the population (any enduring effects of the coronavirus pandemic being not yet fully understood.) Which young person does not want to live longer? – but it is a problem, nonetheless. Therefore, cost-saving efforts otherwise have less than total leverage on the problem, and so the force to be exerted must be that much greater to achieve sufficient overall cost restraint.

In other words, viewed from the limits of the earth's atmosphere, the value of human life is infinite; health care is a right, not a privilege; and so health care should be free and equally accessible to all of God's children. But viewed from sea level, while the value of human life may be infinite, our resources are not. There are not adequate resources today to provide all desired services to all of our people, and given current trends that shortfall will only become more acute year by year into the future. Therefore, to direct our finite resources to where they are most needed, people must be incentivised to make smart choices. And the best way in which we can incent and direct smart choices by citizens in general, as well as by healthcare providers, is to deploy the force of the market, directed to achieve fair and humane outcomes.

Unquestionably, universal national health systems must be supported by means testing in the form of progressive general revenue systems. But exponentially rising costs will require exponentially rising taxes. Governments must find a brake for those health care costs.

Although it would in some countries require an extraordinary shift of fundamental attitudes toward health care, now often perceived as a basic human right available to all for free and without limit as a communitarian value, incentives could be directed in positive and important ways by imposing user fees. This could be done even after the cost of a national health care system is covered substantially or totally through progressive general revenue taxes.

The Rationale for User Fees. The basic rationale for user fees in economic theory is allocational efficiency – in other words, the pursuit of the greatest public benefit for any public money spent. Clearly, in this day of extreme public revenue scarcity, such “bang for the buck” is of crucial importance. Government revenue sufficiency (narrowly defined) is a subsidiary, not the principal, benefit at the theoretical level.

To provide just a very brief conceptual background: Pure public goods, which benefit all citizens equally and from which no citizen can be excluded, would not properly be subject to fees assessed to specific users. The costs of such public goods should be recovered by general, broadly based taxes, and those taxes should be assessed such that the marginal benefit of each public good equals the marginal cost of the funds to pay for it (including its potential benefit to private taxpayers, and collection costs and costs of distortions caused by the tax). The relative progressivity of the broadly based taxes might be thought of as “means testing” of the receipt of the public goods.

In contrast, in instances where goods and services with separable benefits should or must be produced by government, the efficient allocation of resources requires that a price be charged. Such goods and services should not be perceived as “free” by voters and taxpayers, lest they demand too much of them. The classic case is a good or service produced with increasing returns to scale. A private profit-maximising firm would underproduce such a good or service, to the detriment of society. Competing private, profit maximising firms would surely underproduce even more. As a result, such goods or services are better produced by government (or by private entities under governmental regulation), issues of technological stagnation caused by government production without the discipline of competition notwithstanding. Examples include roadway networks, natural gas pipelines, and electricity grids. Building parallel infrastructures would be unnecessarily costly and wasteful, and so public production or in some instances regulated private provision are typically preferred. Adequate recovery of public costs would be necessary to gauge the efficient amount of investment, as well as to assure revenue sufficiency.

That textbook case of appropriate government provision of, and charging for, the use of goods or services is widely accepted. Often, however, institutions fail to change with the underlying circumstances. Institutions often behave today the way they did yesterday, because of inertia rather than continuous re-thinking and self-examination. That inertia can hold in both directions; bodies may remain at rest or in motion. So new technology for the intelligent measurement and routing of flows of electricity might suggest a lessened government role in a more-intelligent electricity grid, for example.

Thus, given the increasing urgency of the festering fiscal problem and the need to extract the maximum value from scarce public funds, policymakers should consider carefully the potential role of user fees in maximising the productivity of each unit of government spending, and also in shrinking the fiscal gap.

User Fees in Health Care. To judge the impact of user fees on free national health care systems, it is necessary to look across borders to fundamentally different systems where user fees are already imposed. In the latter group of national systems, fees are typically used as a resource-allocation device in private insurance plans, and as a result actual data are typically proprietary, and therefore not available for public policy analysis. However, some general lessons can be learned from that experience.

The fundamental premise of health systems is that no important care should be denied. (Individual providers take an oath to that effect.) But if those systems do not provide that care at the lowest possible

cost in today's resource-constrained world, then promises of access to care will sooner or later prove empty.

And if care is perceived as free by individual citizens, they will treat it as though it were resource-free; therefore, costless professional care will be sought in instances of minor medical conditions where those professional resources have a very low payoff – surely less than the opportunity cost in alternative applications. But perhaps even more importantly, professional care will be sought in high-cost settings even when such facilities are unnecessary, and less-costly venues are readily available. The quintessential example is resort to the hospital emergency room, which must be equipped for sudden and catastrophic illness or injury, and thus is among the costliest settings for care. And that cost is measured in more than money; an emergency room bed occupied unnecessarily by a sufferer of a severe cold could delay the care of the victim of a sudden serious injury or illness – with tragic results.

And given advances in technology, exploiting low-cost modes of treatment is becoming ever easier. Advice can be dispensed over the telephone with expert systems to identify cases where in-person interventions are in fact necessary. The same can be done through Internet questionnaires where the initial screening is done by the expert system in an app or via e-mail where a health care professional can review the patient without engagement in real time. Photos can be sent via the Internet if that would provide useful information. Video conferencing can allow in-person professional review time-efficiently, and without a sick and potentially contagious patient being exposed to the elements or to other potentially contagious patients. And yet all of these advances may be underutilised if all treatments are free and patients simply make office appointments – which they may perhaps later ignore without personal cost, wasting the time of the provider. Or worse, patients may just trundle into the provider's office; or worse still, they may invade the hospital emergency room and overload the system.

Pharmaceuticals are of course a substantial part of healthcare costs. User fees can be set at varying levels to steer patients from prescription to over-the-counter medicines, and from name-brand prescriptions to generics, saving cost for the system and ultimately for the patients with no loss in quality of care. This might still allow the system to make available name-brand drugs for patients who need or prefer them, and are willing and able to pay the extra cost.

More controversially, but ultimately perhaps with equal efficiency gains, user fees can steer patients from low-value and higher-cost treatments and providers to higher-value and lower-cost alternatives. This requires that the health care system render judgment about the relative merits of treatments and providers, which must be done thoughtfully and purposefully. A more limited application of the technique, if physicians are for some reason allowed to set their own fees to charge the system, would be for the system administrators to set a higher user fee for patients who choose to see a higher-cost provider.

As noted at the outset, current systems that are completely free and charge no user fees are precisely those that have no experience base on which to assess the potential efficiency benefit of fees, and health care providers who currently employ user fees to guide patient behaviour almost universally hold their proprietary experience close. However, healthcare systems employing the kinds of fees described immediately above find that roughly only one-third of their estimated net savings come from the revenues themselves, and about two-thirds comes from the more cost-efficient patient choices that the fees induce. Thus, looking at user fee revenue of any existing public healthcare systems would likely substantially understate the actual savings realised, and also the potential savings for currently free systems should they employ user fees. This conclusion of course assumes that user fees are designed strategically to guide patient behaviour, rather than being set mindlessly at some fixed percentage of the cost of all services. There would be a learning curve of finding the fee design that encourages the most efficient behaviour.

But importantly, when considering the seemingly inexorable and unsustainable rise of health care costs in total, it is precisely the changes in behaviour that can contribute most to longer-term cost sustainability. The net health care cost problem will not be solved with a continued unsustainably and exponentially rising

stream of costs partially offset by a future stream of exponentially rising fees. There is much more to health care cost control, of course, including finding ways to encourage healthy choices (exercise, dietary restraint) throughout patients' daily lives, but user fees could at least push in the right direction.

Still, there remains the question of equity. The lowest-income households cannot afford health care user fees that pile on their problems when they are sick. At the same time, it would of course be best if even low-income households could be steered toward resource-efficient health care choices.

One option would be simply to excuse low-income households from all user fees. Such households would be given some form of identification to show that they were fee-exempt. There would be some administrative cost in verifying status, distributing the identification, and preventing trafficking in identification at the healthcare delivery site. There might be some concern about stigmatisation of those who are identified as lacking the ability to pay. If so, all patients could pay user fees through visually identical health care debit cards, to which affluent families would be required to make electronic cash deposits. This option would leave the identified low-income population with no incentive to alter its behaviour, however, and especially if a large portion of the population were designated as low-income, this might significantly reduce the benefit from more-efficient allocation of healthcare resources.

A second option would extend efficiency incentives to all households by charging user fees to all. Low-income households would receive a single purpose health care debit card with a pre-deposited balance to pay the user fees. But those low-income households would be allowed to keep all or part of the unused balance on the card at the end of the year, to encourage them to make resource-efficient choices. It would be necessary to put additional deposits on the cards of low-income households who experienced much illness or injury, so that they could continue to pay the user fees for care. Again, security of the debit cards would be important to the success of such a system.

There are multiple issues of fairness, and perceptions of fairness, in health care. Charging user fees might offend some people in the sense that those who are sick would be worse off financially than those who are well. Of course, either financially or in terms of well-being more broadly defined, people who are sick are worse off even if the health care is totally free (given that sickness adversely affects earning power). Still, some might be more willing to accept such ill fortune for the sick if it arises from pure chance than if it is caused by public policy. And particularly if low-income households are allowed to keep unused balances on health care user fee debit cards, there would be a public-policy-induced randomness to outcomes depending upon, for example, when relative to the borderline between years an illness happened to occur. And there would be a tension in programme design as to how much of the unused balances a low-income household should be able to keep. If the potential savings to the family is too great, the benefit to the healthy might seem unfair; but if the amount to be saved is perceived by individual households to be too small, that amount might not induce the affected families to adopt resource-efficient behaviour. Also, any return of unused balances to low-income households would be a net cost rather than a net saving toward the overall objective of reducing the budget deficit.

Another broad policy option toward those with low incomes to accompany any programme of user fees might be a targeted income tax cut, or a low-wage subsidy increase, that would offset part (but not all) of the newly imposed fees. However, that again would reduce the contribution of fees against the overall budget problem, and it would be essential that the tax cut or wage-subsidy increase was targeted closely to the incidence of the user fees themselves.

Yet another option might be to attempt to enforce efficient choices on low-income households by putting them in their own managed-care programme that would require appointment clearance by "gatekeeper" health care personnel, impose choice of generic drugs, and the like. Such a separate programme could entail stigmatisation, and forbidding initial approaches to hospital emergency rooms might save money but also cost lives in true emergencies. Resource scarcity has no happy consequences.

Many of these issues appear complex and likely to cause potential inequality. But it is essential to be realistic. Exponentially growing total health care costs will be extraordinarily difficult to slow. Straightforward health care spending cuts such as reducing the number of providers, reducing the compensation of providers, closing facilities or the like will (1) save money only at the expense of the quality and availability of care, and (2) not reverse the underlying exponential growth of the cost of providing service to each individual patient. Meanwhile, demographic forces will continue to accelerate the growth of the need for care and slow the growth of the numbers of taxpayers to bear the cost. The only way to square this circle is to increase the efficiency of the delivery of care. However – no surprise – the ultimate benefit of anything that we try to do to improve health care efficiency, no matter how well it is designed, is no more predictable than product and production efficiencies in the private markets for goods and services – which is to say, not predictable at all. User fees can be one important tool in the struggle for improved health care quality and efficiency, but any move toward user fees will require careful study and design and still will be a leap of faith in the efficiency of markets (which always does seem to be the best bet available) but does not convey even the limited degree of certainty that we usually expect from budget policy. And this is especially true to the extent that user fees induce efficient behaviour which reduces outlays rather than contributing user fee revenues, because the latter are easily countable, but the former decidedly are not.

Education

Universal education is a pillar of free societies. Citizens must be informed if they are to fulfil their civic obligations – ranging from making judgements in elections to reading and obeying traffic signs. And if for this reason education is to be compulsory, it is not a long leap to conclude that it must be free.

This argument of course was born with elementary education, and then extended to secondary education, the two levels of schooling most clearly linked to the knowledge and socialisation needed for constructive participation in society. But it is beginning to be extended from the elementary and secondary levels, where education is available for free almost universally (although privately paid education is also generally allowed), to the tertiary (sometimes called postsecondary) levels, where payment of tuition is required in most countries. The same argument is sometimes extended in the other direction, to the pre-elementary levels, as well. Each of these levels of education raises its own issues, but aspects of all education should at least be considered with respect to user fees.

Tertiary Education. Some argue that the development of our societies has rendered tertiary education just as fundamental to citizenship today as were elementary and secondary education a century ago. These convictions are driving proposals to make at least two years of college available for free.¹ But on the other side, many scholars would argue that there are still substantial private returns (in the form of higher future earnings) to postsecondary education for which attendees arguably should pay. Those experts might argue further that “college is not for everyone,” citing both conspicuously successful college dropouts and the availability of good-paying technical service jobs (electricians, plumbers, etc.) that are well within reach of many students who would not be well suited to college. These experts might add that compulsory or even voluntary free college would require substantial additional investment in personnel, buildings and equipment, would require rationing of scarce education capacity until more could be acquired and built, and would waste enormous amounts of resources, including years of attendee participation in the workforce.

Tertiary education has become a major cost driver for many governments or families, depending upon the education finance structure of the nation in question. Higher education is highly labour intensive, and productivity growth to date has been limited and uneven; and so costs have risen at an alarming pace in some countries. In theory, technology could be used to convey knowledge, including through digital remote video classrooms, distribution of text materials, and submission and even grading of assignments. In

practice, employers are uncertain of the value of non-traditional postsecondary education, whereas older traditional institutions, which rely on the “laying on of hands” rather than new digital productivity enhancements, are more known and trusted.²

National systems for the financing of tertiary education are dizzyingly diverse. There are different divisions of the tertiary education sector between public and private institutions. Some nations do not charge tuition. (Non-national students are often treated differently in this respect from national residents.) Where tuition is charged, the amounts may or may not be regulated. Some nations provide financial aid for even non-tuition expenses; others do not. Tuition (and other) aid is divided among grants based on academic merit, grants based on financial need, and loans, in different mixes and proportions from country to country. Loans may be repaid on normal financial or income-contingent bases. Interest rates range from zero to subsidised to market levels. Interest charges may or may not be forgiven during schooling or for some duration thereafter.

In some nations, tuitions are used as a steering device for the choices of fields of study. Tuition may be set lower in fields where the costs of education are lower; they may be lower to induce students to enter fields that are perceived to be undersubscribed, which may or may not reflect the prospective earnings in the particular field. Or tuitions may be reduced to lead students to enter fields on which the nation sets a high priority for research, and tertiary education institutions may or may not be used as vehicles for such research. The funding of research itself is a kind of random, non-educational element in the budgets of institutions of tertiary education, and in the tertiary education budgets of nations.

Thinking of the tertiary-education financing system of any given nation as a combination of check-the-boxes choices among all of the elements enumerated above (and more) illustrates the potential variation among those systems; and the reality is that the actual variation fully lives up to its potential. And it follows from this multiplicity of parameters that no one indicator necessarily expresses the generosity of a system. So for example, a system that charges significant tuition but offers large amounts of financial aid (which could include loans on highly favourable terms), not only for tuition but also for non-tuition costs, might be fully as generous as another with lower stated tuition but limited aid. And it could be misleading to consider tuition nominally paid by students and their parents to be burdensome if those payments are subsidised by any forms of public aid.

On that one side of the figurative coin of tertiary-education finance is what the student (and the nation otherwise) pays; on the other side is what the student gets. Labour market conditions change constantly, but still graduates of tertiary education receive significant returns on whatever financial investments they may be required to make. This is true both in terms of employment rates, and amounts of earnings given employment status. There are concerns that today’s rising numbers of young workers with tertiary credentials will dilute their earnings advantage; but validation of those concerns is confounded by the longstanding regularity that returns to education tend to increase with age, and so only the passage of time will truly tell. Still, recent data indicate that any reduction in the relative earnings of young, educated workers must be quite small. A further concern that returns to education may be disrupted in the wake of the pandemic cannot yet be verified.

Thus, even if there are significant social returns to tertiary education – in terms of citizenship skills, reduced social costs of unemployment, or external benefits of an educated workforce in the forms of technological progress to be shared by all – there are also private returns in the form of higher earnings. Thus, the private returns are likely to continue to attract qualified candidates into higher education, and it would be fair for society to expect those who benefit to pay a substantial share of the costs.

That reality, plus the rapidly growing cost of higher education, dictate that even countries that see no-cost higher education as a communitarian value or the birth right of citizenship must at least consider charging user fees for those who enjoy personally beneficial tertiary schooling. As a first approximation, given the complexities of the various national financing systems, those nations that spend the most public funds would be the best candidates for “progressive spending” on tertiary education.

There are several ways in which forms of user charges for tertiary education can be, and in some instances are being, implemented in real time. Parents can be charged income-conditioned tuition with assessments calculated through the income tax system. If parents have no ability to pay, students could in effect be given loans which could be repaid after they left school on an income-contingent basis. Students or their parents could also be assessed for housing and incidental expenses, again on an income-conditioned basis.

One necessary caution is that any increases in student costs must not further inhibit qualified low-income students, especially those who have no family members who have completed tertiary education, from attending. It is a risk, even a blind leap into the unknown, to commit future income while forgoing current work to pursue an opportunity that they may well not fully understand. Beyond targeted grant aid for low-income, first-in-family college attendees, there is a need for guidance counselling support before and even during school attendance to allay fears and facilitate sound education and career choices. (Also needed in some countries will be consumer protections to prevent exploitive institutions from taking advantage of any additional financial assistance that might be committed to expand opportunity.)

Earlier Years of Education. By far the greatest opportunities for targeting spending and achieving efficiencies in education arise at the tertiary level. However, there is reason to examine earlier levels, especially early childhood education (ECE).

ECE can be vital to life prospects, including success beginning in elementary school. Furthermore, preschool education of very young children at risk of poor preparation for elementary school can provide significant equalisation of opportunity. And availability of ECE can be essential for some working parents.

The vast majority of children ages three to five are enrolled in ECE. In more than half of OECD countries, enrolment is almost universal (more than 90%). However, as the differences in those figures suggest, some countries lag well behind. And enrolment of children before age three can be just as important, and lags well behind.

There is reason for concern about access to ECE, beyond its manifest value to children. Troublingly, enrolment appears to be lower for at-risk children – precisely those who would most suffer from entering elementary education a step behind their peers, and who would be most likely not to catch back up (OECD, 2022^[10]). For this reason, free or highly subsidised preschool should be of the highest priority for low-income households, while more-affluent households could be assumed to pay for preschool without a subsidy, or to provide high levels of experiential learning in the home.

If efficiencies are needed to expand or at least maintain access for at-risk children from low-income households, it would be relative relatively simple to charge parents an income-conditioned tuition. For many upper-income two-worker couples, such a charge would be little more than a fee for childcare.

Elementary and Secondary Education. The elementary and secondary years of education are of course compulsory. The rationale is that such education provides the knowledge base for good citizenship, and thus is a public good; and that there is a communitarian value in all students having a shared common experience in key public values. This rationale replaced a perspective implicit in our societies more than a century ago, when elementary and secondary education was optional, that the communitarian value of citizenship training and education was dominated by the augmentation of personal earning power through such education. Today, in the views of most observers, that calculus is reversed.

Households who “opt out” of free public education by sending their children to fee-based private schools are not relieved of the progressive taxes that finance the public schools. Thus, one might argue that elementary and secondary education already conform to a user-fee or means-tested model. (Households without children pay the same taxes, indicative of the sense that elementary and secondary education is an essential building block of a healthy society for all.)

However, there are some necessary expenses of elementary and secondary education that are arguably personal in nature that could be subjected to user fees which could be graduated by ability to pay. Textbooks and other materials could be financed by fees. Meals are sometimes provided by schools, and for very-low-income families a free meal or two each day may be the only protection against actual hunger for the worst off. Charging each student a cash fee for each meal on a means-tested basis has been criticised as stigmatising those students who are given some form of voucher to present at school instead of cash. However, payment can be required by parents outside of the school day and can be assessed according to ability to pay while providing all students with the same identification – for example, using electronic debit cards that are provided balances through cash payments from the affluent families but at no charge to low-income families. This could make all students indistinguishable from one another at the end of the cafeteria line.

Other public programmes

However, the need for user fees does not stop with the textbook case of government provision of goods and services under conditions of rising economies of scale, or with all of the progressive spending applications in place today. Fiscal pressures are heavy enough that even smaller opportunities for greater targeting of public resources must be pursued. And it is easy to overlook changes in our circumstances that require changes in policy. As just one example, the evolution of the global economy may call for new or increased user fees. With increased globalisation of production and trade, government is more involved with international commerce and finance in many respects. Government-to-government interactions are necessary for trade agreement negotiations, customs clearance, public health protection, and services to facilitate permitting, licensing, and other aspects of overseas operations. Governments provide support in trade promotion and tourism. Government can and should (and in at least some instances, does) charge for the value of such services that government alone can provide. Such charging must be undertaken efficiently.

The appropriateness of fees for such government services will be subject to dispute. Some might argue that fees for services in pursuit of foreign trade will reduce business efforts to export, especially for smaller businesses exploring export opportunities speculatively or for the first time under great uncertainty, or firms in fully competitive industries where economic profits have been bid away. Fees for tourism promotion might be difficult to assess accurately where the economic benefits are widely diffuse among small retail and hospitality business providers and are difficult to measure. In all of these instances, fees might be considered self-defeating by countries whose neighbours would provide such services for free as a subsidy to their domestic businesses. Still, there is little question that such fees would be appropriate for larger firms with some market power. Even for firms subject to perfect competition, the expense of such government service is surely a valid cost of doing business. Fees for new exporters could be deferred or contingent. Fees for tourism promotion could be assessed through local government and based on changes in sales or property values.

Natural Resources. A second class of potentially underexploited fees for government production is natural resources. Public lands, including offshore areas within national control, can be essential sources of minerals, or of space needed for generation of wind or solar renewable energy. Public lands can be essential for animal grazing. Public lands can provide natural beauty that is the essence of national or sub-national parks and recreation. Owners of private lands would charge for such resources or services. Again, if user-taxpayers are under the mistaken impression that such resources are free, they will demand more of them than is efficient, including that users who place a comparatively lower value on those services may crowd out those who value them more highly but have no way to signal their higher demand.

To some, public land and even natural resources may be seen as the birth right of the citizenry, and imposing charges for their use might seem to violate that important principle. For example, ranchers may

believe that public grazing lands belong to them as citizens, and therefore may believe that charging for their use violates their fundamental rights. Of course, the rational answer to such an objection would be that those lands also belong to all other citizens, and so there must be an adjudication of which citizens may use them. Another potential objection might be against charging for the use of parks and recreational facilities specifically if there are concerns that lower-income households might be deterred from experiencing their natural birth right. Of course, low-income households are restricted in their enjoyment of private goods and services as well, including even the necessities of life, and the concern is surely more in their restricted access to all goods and services than simply in their access to public parks and recreational facilities. The proper remedy is surely addressing income inequality in the broadest sense.

There may be some entirely new opportunities in this area. Government costs today might be zero if government is simply giving away such public national resource wealth. But on behalf of the taxpayers at large, government should charge users of those public resources as would private owners of such resources. Imposition of such user charges would encourage the efficient use of such resources by steering them to the users who could extract the greatest value from them. At this time, some public resources may be used by the private sector – by households enjoying recreational facilities, or by businesses exploiting resources on public lands, for example – with no cost recovery at all. Every national situation will prove unique. Different nations will have different amounts of such endowments. And there are natural resources of all types that are cheap and easy to extract, and there are identical resources that are expensive and difficult. Fees for all should be derived according to market values, but those values will be hard to predict. Still, identifying the opportunities is worth the effort.

Roadway Networks. The issue of financing roadway networks is particularly timely because of remarkable technological developments. Motor fuel taxes often play an important role in highway financing. The rapid current adoption of electric-powered vehicles could render that financing source virtually obsolete within just a few years. But even before the rush to electric vehicles, some policymakers raised questions about the fairness and efficiency of a tax based on fuel consumption, given that more-fuel-efficient vehicles wear down the roadways virtually as much as internal combustion vehicles that are more fuel efficient. High-powered electric vehicles can wear roadways even more. Already, improving internal-combustion-vehicle fuel efficiency threatened the adequacy of the fuel tax base for highway construction and maintenance. This can be a pressing reason to re-examine the current portfolio of user fees, both for budgetary adequacy and for efficiency; some experts believe that the technology to charge a user fee on the basis of distance driven is already more than adequate.

Research and Development. Another potential application of user fees could be funding government expenditures on research and development. Public R&D has long been considered a public good, providing knowledge that is useful throughout the economy, and from which potential users cannot be excluded because of the generic nature and the inherent transmissibility of that knowledge. That traditional interpretation remains widely held. However, in a global economy with increasing manifestations of market concentration and monopoly or oligopoly market power, it may be that the benefits of public R&D are not being spread throughout the economy, but rather are being appropriated by already successful private businesses who achieve first-mover benefits, or who use their deep pockets to acquire technological upstarts before they can pose a competitive threat. To the extent that this is accurate, user fees in the form of business licenses and payments of royalties for the application of publicly funded technologies might be appropriate.

Cybersecurity. Yet another potential application of user fees lies in the complex issue of cybersecurity. Cybercrimes are difficult to attribute, because the medium facilitates anonymity, and crimes in one locality can be committed anywhere else in the world. Some instances are surely simple cases of what amounts to personal theft. But other perpetrators have been identifiable as state actors, or as individuals sponsored by states and seeking state objectives in whole or in part – where those objectives could include disrupting a rival nation's economy, or its infrastructure, or holding it hostage to those or other threats. Honourable

firms might simply be expected to finance their own cybersecurity. But even many medium-sized firms lack the economies of scale to do so effectively. Furthermore, a firm that has been attacked successfully has a strong incentive to conceal the attack, in fear of reputational risk with respect to customers and clients. Silence about current successful attacks prevents other potential targets from learning of those new threats. To obtain the leverage of government in dealing with state-executed or -sponsored cybercrime, including to infrastructure or other national values; to achieve economies of scale in security and to share knowledge about new threats; and perhaps to provide insurance against large losses in partial exchange for transparency about new and innovative attacks, there could be a role for government to participate in a national strategy for cybersecurity, and to charge for its contribution to the effort (Archbold, Hart and Minarik, 2019^[11]).

But again, beyond these fields, a user-fee or means-testing policy that makes a substantial dent in the fiscal shortfall must go where the money is. And that suggests three components of government services with the most rapidly rising costs: education, health care, and retirement. These three functions have among the strongest communitarian rationales of all government programmes. Still, the damaging and growing fiscal gap may require that government rethink and perhaps persuade and lead on these targets of user fees and means testing.

In sum, the merits of user fees today are by no means limited to their contribution toward fiscal stability. However, if fiscal stability should motivate the consideration of new applications of user fees, the ultimate benefit to nations and taxpayers could prove to be above and beyond what was originally bargained for – in the form of an improved allocation of resources in the economy, also perhaps described as a greater productivity of the resources deployed by the public sector.

Conclusions

Reducing fiscal imbalances is an international imperative. Just as extraordinary circumstances such as the financial crisis and the pandemic contributed massively to the worsening of the problem, so those circumstances distracted the financial markets from its longer-term implications. In that sense, the gradual return of normality is in some respects bad news. It is as though our global economy is awakening from a bad dream, only slowly to realise that at least one part of that nightmare – the massive accumulation of burdensome debt – had actually occurred while we slept.

And that accumulation of debt is indeed massive. Debt in most nations has reached levels that would have been unimaginable – if not terrifying – two decades ago. Only the risks of financial crises and pandemics in the intervening years have numbed us to the building perils of debt.

Many nations' bodies politic are polarised – with almost half of the citizenry refusing to raise taxes, almost half unalterably opposed to cutting spending, and the balance of power in the hands of a third group that rejects both. Any device to break the logjam would be welcome.

There is reason to believe that user fees and means testing could contribute to a solution. Given the magnitude of the problem, only a truly serious approach to targeting public spending will do. National fiscal systems and government establishments differ widely, and thus, the potential for budgetary savings through means testing and user fees will differ as well. But for many nations, there are real opportunities. Many national retirement systems have traditionally been funded in the long run, but are not today in the wake of demographic transitions, and could provide an independent rationale for substantial fiscal consolidation through means testing. Slowing the runaway growth of healthcare costs through structural reforms, including market-based incentives embodied in user fees, could have a large and growing impact on sectoral costs with consequent overall fiscal relief. Natural resource fees yielding environmental benefits, and highway user fees that fund infrastructure rehabilitation more fully than today, could also be part of a co-ordinated programme. It is an opportunity worth exploring.

The benefits could materialise in unexpected ways. As was noted above, user fees can be designed to reduce, or may have the unwitting effect of reducing, underlying budget outlays to a degree even greater than an increase in receipts. The earlier discussion cited the potential role of well-designed user fees to reduce demand for low-value health care services, such as visits to emergency rooms for routine problems, or professional appointments for ailments that could be effectively addressed by self-medication. A fuel tax designed as a user fee for highways may have a subsidiary effect of discouraging driving, perhaps intentionally in the pursuit of reductions of emissions as well as roadway wear and tear. A user fee that purposefully and perfectly deters the demand for a particular class of service not only reduces the corresponding outlay, but also is of course never paid in the first place. (As one imperfect example, the excise tax on tobacco in the United States was increased sharply, and had a powerful, and intended, effect on consumption; in so doing, it held down the amount of revenues collected.) Thus, one might examine a budget document and conclude that the user fees that are in fact the most powerful are very little employed. Therefore, tracking the current use of user fees might be an exercise for a budgetary “bean counter,” but it will be impossible to count such “might-have-beans” without highly sophisticated analysis. Thus, the consideration of a proposed new user fee must include the public’s behavioural response.

User fees can have benefits that are not budgetary at all. A user fee might reduce negative externalities, such as the imprecise example of the excise tax on smoking, and in that way might make society better off; but by reducing the use of the activity that causes the negative externality, it might underproduce expected revenue, and might have only a limited impact on outlays as well. For example, the reduction in smoking had only a limited short-term impact on the rate of growth of public health care expenditures, and by extending lifespans it may actually increase public retirement payments in the long run. But few would challenge an initiative with such massive benefits to the public’s health and well-being.

Thus, there are many reasons to increase the targeting of public spending – to improve the allocation of resources, raise the quality of life, and promote equality, among others. But applying current best practices and evolving even better ones could also help to address the threatening budgetary imbalances and the resulting build-up of debt, perhaps ultimately above all other objectives. Exploiting these opportunities for improvement could be very constructive – perhaps essential – at this difficult time.

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Notes

¹ From the United States: “The Budget also expands free community college across the Nation through a new Federal-State partnership. To lay the groundwork for this programme, the Budget includes USD 500 million in a new discretionary grant programme to provide two-years of free community college for students enrolled in high-quality programmes that lead to a four-year degree or a good-paying job (Office of Management and Budget, 2023, p. 69_[13]).

² Attempts to create credentials to facilitate education productivity improvement and provide students with documentation of their skills have met with limited success (Marcus, 2021_[12]).

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This issue consists of 5 articles: 1) Rise of non-standard policy instruments: Can budgeting catch up?; 2) Medium-term and top-down budgeting in OECD countries; 3) Targeting public spending: Means-testing and user charging; 4) The emergence of strategic budget initiatives; and 5) OECD performance budgeting framework.

