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Sustainable development, sustainable budget as viewed by international economic and financial organizations

The concept of sustainable development became widely known after 1987. It was introduced in the Brundtland-report,[1] i.e. the final paper of the UN's World Commission on Environment and Development – a body established in 1983: "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." Although the environmental aspect of the term enjoys most of the attention today, sustainable development equally includes economic, social and ecological equilibrium.

In recent years, UN organisations and international development institutions have put an increasing emphasis on social considerations, i.e. on implementing inclusive development, beside environmental aspects. This is mainly related to their commitment to overcome poverty which is expressed in the so-called Millennium Objectives. It must not be neglected, however, that relevant international benchmark surveys indicated a strong correlation between the sustainability of growth and social cohesion.

The OECD is paying a lot of attention to the social and economic aspects of sustainable development and its environmental, agricultural, natural resources management, technological, human resources-related and social, etc. implications. They look at how today's needs can be fulfilled without restricting the opportunities of future generations to fulfil their needs. The main objective is human well-being in a broad sense. Experiences are discussed at conferences and published in various publications.[2]

MEASURING SUSTAINABLE GROWTH

The measurement of sustainable growth is a highly complex task. No wonder that so many publications were written about related research efforts and that the explanations and approaches provided therein are so diverse.

A joint UNECE/Eurostat/OECD work group was established in 2005 to examine the statistical consideration of sustainable development. The purpose of the work group was to assist national governments and international organizations in revealing concepts and real-life solutions by creating a system of indicators that characterise sustainable development, establishing an official statistical system that is specific to the topic and proposing a bunch of indicators with not too many elements which is

suitable for international benchmarking. Although the comprehensive study[3] drafted by the work group was officially prepared for the UNECE, for the OECD and for the statistical offices of EU member states, it is expected to draw much wider interest. One of the duties of the work group was to compare existing, economic-policy based indicators to a possible new set of indicators that take into consideration the various forms of capital.

The complexity of the task is well illustrated by the fact that the team first had to come up with an agreed definition of sustainable development. Although the professional background of work group members was similar, this was not an easy exercise. Finally, they approved the practical explanation that *sustainable development is the growth of well-being in the broadest possible sense over a very long time.* What is important in this definition is that "well-being" not only encompasses the usual meaning as used by economists, i.e. the consumption of goods purchasable on the market, but also covers free goods or even the enjoyment of natural beauty, while "very long time" means several generations.

The survey carried out by the work group found that in countries where indicators were already in use for describing sustainable development, the indicators mostly serve to fulfil the specific information needs of the national sustainable development strategy (focused on environmental considerations) and are rarely based on a comprehensive concept. In many countries, the process of setting up sustainable development indicators gave way to the adoption of environmental awareness at higher government levels and helped make environment protection a matter of identical importance to economic and social issues. (This is one reason for the overflow of environmental aspects in communication.)

Surveys found that countries did not care much about international comparability when establishing the system of national indicators – although aspects of global significance, e.g. the emission of greenhouse gases is part of each national indicator system. Nevertheless, some similarities were found within the European Union which may have two possible reasons. First that the EU's approved system was developed based on the relatively well-founded system of old member states and second, that the new members took into consideration the EU's system when setting up their own indicators. The survey compared the indicator systems used by 20 European countries (Hungary was not included), two non-European countries (Australia and Canada) and two international institutions (the EU and the UN). A total of 27 indicators were identified which were used in at least 10 systems.

The other task of the work group was to develop a concept that is based on a capital theory. From this viewpoint, sustainable development is regarded as a state where per-capita "wealth" is not decreasing. What it means is that the expansion of goods must match at least the rate of population growth. (This does not say much about the distribution of wealth yet.) It must also be assumed that the development potential defined this way would not be wasted by subsequent generations on e.g. wars or a relatively luxurious lifestyle. *Therefore, per capita economic growth does not guarantee the sustainability of development but the lack of it definitely annihilates sustainable progress.*

In this capital-based concept, all goods and services are regarded as items that cannot be produced without capital and human contribution. As "consumption" is used in a rather broad sense, however, "capital" must be defined in a similar manner. In this approach, the capital of society consists of five elements:

- financial capital (e.g. shares, bonds, deposits),
- produced physical capital (e.g. machines, buildings, telecommunication and other infrastructure),

- natural capital (natural resources, agricultural land, ecosystems that are uses for a specific service, e.g. for the absorption of waste),
- human capital (trained and healthy workforce), and
- social capital (operating social networks and institutions).

Therefore, what needs to be examined with this approach is whether the per-capita quantity of these individual types of capital increases or not and if the decrease of a specific element (e.g. the expiry of crude oil reserves) is compensated by something different (e.g. by the growth of human capital, innovation).

Specialists point out that the capital-based approach has its difficulties as well. It is hard to find a common unit of measure for quantifying the diverse capital types. Money is the only obvious choice, but there are a number of problems with it. First, it is not easy to determine accurately the nature and way of contribution to welfare for each capital element. Second, due to the imperfection of markets, even the known value of contributions is difficult to express in money amounts. Furthermore, there are a lot of ethical questions, like the extent to which we can alter nature for the sake of mankind. Another difficulty with evaluation is that *the various types of capital cannot substitute for each other unlimitedly and irreplaceable, critical capital elements must not be aggregated with replaceable ones.* Due to all these reasons, it was deemed appropriate to use supplementary indicators in addition to the financial ones which characterise the limited substitutability of capital types and the critical capital elements.

The international expert work group proposed that for goods and services that can be bought and sold on the market, market value should be considered a good indicator of contribution to welfare. This applies to all financial and physical capital, many elements of natural capital (e.g. timber, fish, minerals, energy) and to the marketed element of human capital (labour). However, market value can only be observed directly in the case of financial and physical capital and of certain elements of natural capital. The majority of natural capital elements, however, are not traded on the market. For these and the value of human capital, widely used indirect estimates are available. However, the value of social capital is the most difficult to quantify, for neither directly observable market estimates nor scientifically elaborated indirect estimates exist for it.

In recent years, World Bank associates elaborated an evaluation method for the comprehensive estimation[4] of economic value and it is cited by the authors of the study. With this method, the net present value of future market value is calculated by taking future market revenues as the grand total of expenditures on goods and services available on the market and of net investments into the various types of capital. The specialist of the World Bank applied this calculation method to more than 100 countries. It should be noted that the e*conomic wealth* calculated this way is sensitive to both assumptions on future revenues and to the discount rate used for calculating the net present value. The authors of the UNECE/Eurostat/OECD study point out that whenever this method is used for generating indicators for official statistics, the underlying assumptions must always be stated explicitly.

Most of the well-known critical capital elements are in natural capital. (In everyday references, it again leads to the frequent emphasising of environmental considerations.) Although the exact list of critical i.e. indispensable elements is subject to disputes, there is extensive consensus that the list includes sufficiently stable and foreseeable climate, safe air, sufficient and good quality drinking water and natural territories that are suitable for preserving biodiversity. Certainly there are other capital ele-

ments that are critical e.g. in respect of social capital, but no sufficient knowledge has been found yet for the specification of these. In the indicators, these elements are only reflected currently as spare empty spaces.

The other set of supplementary indicators is necessary because certain capital elements do not contribute to overall well-being through the market. While this is little of an issue in the case of financial and physical capital, it is often the case with natural capital when we directly use and enjoy nature. These non-market capital elements which provide a "sense of well-being" are greatly identical to the critical capital elements listed above, i.e. they can be characterised with the same indicators. Human capital makes an impact mostly outside the market. Researchers pointed out that education, proficiency and good health may not only make a better workforce but better parents as well – helping people to find their place in society, enjoy arts and reach a higher level of personal satisfaction. This is why it is advised to apply separate indicators for education and medical condition.

Regarding social capital, the members of the work group propose the use of indirect indicators (e.g. participation in local organizations and networks, trust in norms and compliance with them, collective action).

Besides *stock*-type indicators, the international work group also saw a need for *flow*-type indicators as these enable the tracking of the reasons of significant changes over time. All in all, it is about the itemization of net investments into all assets. In respect of social capital, a part of the indicators are still spare space without real content yet.

Finally, specialists proposed an experiment with a total of 14 stock indicators and 14 flow indicators. In advanced countries, proven methods are available for the calculation of most of these, although sometimes the methods relate to scientific research as opposed to official statistics.

THE DYNAMICS OF SUSTAINABLE GROWTH

While in everyday parlance sustainable growth is used with different meanings, it is outlined in macroeconomic textbooks as a logical model that is based on accurately defined preconditions. These textbooks emphasize that the long-term pace of sustainable growth is considered to be equal to its actual growth rate although the economic policy of governments is unable to influence it *directly*. However, the government is definitely able to affect short-term growth directly and extensively. Having analysed the impact of economic policy on growth potential, researchers also present[5] (e.g. op. cit. pp. 343–344) that it is not the dynamics but the factors of economic growth that fiscal policy has a direct impact on (technical development, research expenditures, human capital, investments, general finances, taxation, savings, capital influx, etc.) and this impact is exercised in a highly complex system. The analysis of the sustainability of growth is often part of the comprehensive country reports prepared by the IMF, the World Bank and the OECD. Furthermore, the specialists of international organisations carried out a number of comparative examinations as well.

With years of work, IMF specialists carried out comparative analyses for 140 countries, examining the lastingness of growth.[6] Having analysed growth trends, they took into consideration the fact which is already known in technical literature, *that growth in developing and transitional economies is much less even than in developed countries* and that the quick boom is followed by frequent stoppages and setbacks. Consequently, the results of average growth rate calculations may be misleading. Many experts were investigating the possible causes of sudden setbacks and restarts of growth. Former regression calculations that were reviewed comprehensively in the study did not provide a clear picture. Sometimes they led to

the obvious, expected reasons, e.g. that the existence of an appropriate institution system is important for achieving growth, or that macroeconomic instability, the collapse of exports and war conflicts caused sudden setbacks while sometimes the calculations did not provide sufficient guidance. E.g. the analyses showed that the stoppage of investments, not surprisingly, triggers a setback in growth. However, they did not prove that concentrated, high-volume investments unconditionally lead to a lasting acceleration of growth.

Based on former statements in technical literature, IMF researchers came to the conclusion that the *factors that trigger growth are not necessarily identical to those that maintain growth over a long period of time.* In the research project discussed here, participants only focused on the latter, i.e. the factors that serve the sustaining of growth and examined items that impact the length of the period between the start of growth and the next setback known as the *growth spell.* (As a curiosity in methodology, *duration analysis* focuses on the likelihood that the growth period is still there after a specific amount of time. This is the same logic as the probability of survival for cancer patients in medical science.) Calculations repeatedly confirmed that external shocks and macroeconomic volatility have a negative impact on the duration of the growth period. What is more interesting is that according to the same calculations, the liberalization of trade not only helps start growth but helps sustain it as well, especially if it is accompanied by a competitive exchange rate and a positive balance of payments. Similarly to other researchers, they found that not only an export oriented economic policy but the composition of exports is also of vital importance. The larger the share of the processing industry in exports, or in more general terms, the more sophisticated the selection of goods, the longer the growth periods. A surprisingly *strong correlation was found between the duration of growth periods and the distribution of incomes:* the smaller the income differences in a country, the longer the growth cycle. (Here it must be borne in mind that in developing countries, the deviation of incomes may be quite significant.) According to preliminary analyses, this correlation may partly be due to the fact that stronger social cohesion leaves little room for populist economic policy. Furthermore, societies that strive for avoiding large social differences usually have a stronger institution system. In any way, further surveys are proposed to reveal more accurately the correlations between social cohesion and more lasting, more powerful growth.

SUSTAINABLE BUDGET

Obviously, a lasting balance is also needed at the level of national economies. International organisations examine multiple aspects of sustainability. One key consideration is that actual economic policy must not put too big a burden on future generations while it should ensure that the government pursues an adequate economic policy in the medium and long run and that it carries out the necessary corrections. In essence, *they describe whether the current fiscal policy can be financed and whether it leads to excessive indebtedness.*

Due to the financial crisis and the resulting severe recession that broke out in 2008, budget sustainability was put in a different light. For the crisis actually entails the increasingly severe disruption of global trends while the achievement of a new, long-term balance requires extraordinary measures and time.

The time horizon in analyses that scrutinize budget sustainability principally depends on the purpose of the underlying calculations. In certain cases when the short and medium-term dynamics of government debt is about to be

analysed, the time horizon may be relatively short. E.g. the assessment of convergence programs in the European Union under the framework of budget surveillance belongs to this category. Similarly, calculations prepared for the analysis of debt service and the dynamics of external debt also encompass relatively short timeframes. This type of analyses is prepared by e.g. the IMF to assess the risk of non-repayment when preparing the disbursement of a loan. In the case of calculations for the short and medium term, the factors to be taken into consideration for the assessment of sustainability include the expiry structure and currency structure of the debt and the average term of new obligations. When analysing external debt, further factors like the dynamics of currency exchange rates, trends in the exports and imports of goods and services and net foreign capital influx must be taken into account. When the global economy is in a "regular" state, these kinds of analyses are mainly prepared about low-income countries and emerging markets. Many analyses of this sort are drafted by the IMF, occasionally in cooperation with the World Bank. In respect of developed countries, the assessment of the fiscal policy and equilibrium of EU member states are often featured topics in the monetary policy report of the European Central Bank which is used for decisions on the interest rate.

By 2008, the IMF elaborated a new set of tools for managing government debt. They emphasise that *an adequate debt management strategy that relies on strong monetary policy and fiscal policy helps the country concerned to resist sudden, adverse market shocks and financial turbulences.*

The calculation methodology[7] elaborated jointly by World Bank and IMF specialists provides a systematic analytical framework for risk assessment and risk-avoiding measures in respect of the various kinds of government debt. Besides, this analytical framework enables the assessment of the country's risk position regarding government debt in a benchmark comparison to similarly developed countries. While the tool itself is a simple Excel spreadsheet, it also enables the consideration of a number of traditional and new measures. The tables can be used also for estimating the costs of a specific debt management strategy.

The authors are of the opinion that a number of factors need to be taken into consideration for the effective management of government debt. These include the assessment of market risk, credit risk and liquidity risks, the level of debt, its expiry and currency structure, the quality of information available on the debt portfolio, the potential costs of the debt management strategy and the coordination of debt management with fiscal policy and monetary policy targets. The authors consider risk assessment the first and critical step in managing debt. Risk assessment enables the mitigation of vulnerability, including vulnerability caused by international financial shocks. Small and emerging economies are regarded as more vulnerable as they are usually less diversified, their domestic savings base is lower, the financial system is less developed and therefore resistance to imported external financial problems is weaker, too.

The assessment of factors with a long-term effect, e.g. the pension system, calls for calculations that encompass a much longer period. In the European Union and many other developed countries, *the aging of the population is one of the key risks to budget sustainability.* Most of the already completed calculations focused on this aspect and covered several decades. This is what the studies issued by EU organs concentrated on. The analyses prepared by international financial and economic organisations regarding developed countries also examined the long-term changes of life structure. The analysis of the lasting budget equilibrium plays a significant role both in IMF consultations

with member states pursuant to Article IV and in the OECD's country studies.

The study[8] on the sustainability of the financial position of EU member states provides a good summary of the methodologies and indicators used by the European Union and of their interpretation. In this study, the attributes of sustainability indicators are discussed in detail.

In order to assess long-term budget sustainability, estimates are developed concerning the extent of budget imbalances. This is needed for understanding the challenges faced by political decision-makers and for gaining an overview of possible and necessary measures. The magnitude of budget disequilibria is characterised with *sustainability* gap indicators. These indicators show the extent of lasting (not only temporary) budgetary corrections that are needed in specific areas. Examples include the permanent budget expenditures that are not linked to the aging of the population or the permanent growth of incomes – both specified as a percentage of the GDP.

Sustainability indicators provide a good basis for assessing the sources and extent of risks that a country's budget is exposed to. The indicators provide information on the nature and size of necessary corrections and on the potential costs of postponing measures to ensure sustainability. Furthermore, sustainability indicators also show the extent of implicit government liabilities that depend on the aging of the population.

Instead of the sustainability gap, the primary balance to be achieved in the medium run in order to ensure budget sustainability can also be used for describing budget imbalances. This is the *required primary balance (RPB)* indicator. It is more stable than the sustainability gap because it only depends on the actual level of debt, budget revenue and expenditure forecasts and on the interest rate but not on the actual structure of the primary balance. The primary balance applied to the future is affected by expenditures that depend on aging. However, once achieved, the RPB is a starting point which can ensure the sustaining of stability in a *no policy change scenario*, i.e. if fiscal policy is not changed.

DEVELOPMENT-ORIENTED ECONOMIC POLICY

In close cooperation with the World Bank, the OECD recommends the methodology[9] of development-oriented economic policy mainly to developing countries. First, they take into consideration the fact that the institutional and specialist resources available to governments in developing countries are relatively limited and second, that donor resources make up a significant portion of budget funds and convincing evidence must be presented on their appropriate utilisation.

In developing countries, it is the Millennium Development Objectives announced by the UN, the strategies required by the IMF and the World Bank (IDA) for overcoming poverty and national or sector-specific budgeting products required by other donors which form the backbone of national development strategies. Therefore, the study refers to these documents and to examples corresponding with the position of the developing countries concerned. The logic of the toolsets used in the methodology, however, can actually be applied in any country. Successful application for European Union support funds must be based on a similar logical framework, too.

The analytical framework is based on the generally accepted principles of sound governance – clear objectives, decision-making based on facts, transparency and permanent improvement. Actual accomplishments and performance are used as feedback for decision making. A key aspect of the method recommended by

the OECD is that a wide domestic consensus is needed and efforts should be made to gain the support of external donors for these national priorities. As part of this methodology, clear and measurable goals are set – what is more, they are specified in the form of a limited number of indicators and targets with deadlines. This *"development outcome"* approach is also applied by the World Bank for the assessment of development programs which it financed with loans.

In order to facilitate comprehension and planning, it is advised to link interventions to results wherever possible, enabling systematic performance assessment. In most cases, logical diagrams are used which illustrate strategies, the correlations between inputs, outputs and outcomes and the achieved impacts.

The generation of a mutually acceptable, prioritised system of targets and strategies is quite difficult both from a political and a technical viewpoint. One characteristic feature of the process is that *ideas and plans must be transformed into a strategy, wish lists must be transformed into priorities and the long list of potential indicators must be converted into a manageable number of specific indicators.* This calls for extensive internal and external consultations. According to OECD experts, the best way to carry out harmonisation is to make it a part of the budgeting process where political priorities can be transformed into tangible budget elements. It usually assumes some sort of a program-based budget in which resources are clearly inked to achievable results. Although no country is using a purely performance-based budget, according to the OECD, many countries made encouraging progress into that direction. Although set development objectives usually cannot be accomplished in a single year, planning is greatly facilitated if medium-term expenditure quotas are set during budgeting and if donors make calculable offers that stretch over multiple years. What makes things difficult, however, is that in most countries planning and budget preparation are two separate processes carried out by separate organisations which are driven by different interests.

RESTORING GLOBAL BALANCE

In the autumn of 2008, it was already clear for international financial institutions that the deepening global financial crisis cannot be managed without extraordinary measures. The possibility of an extensive government intervention cropped up back then. A reference to that actually appeared in the report on the consultation session held between the IMF and the USA pursuant to Article IV in July 2008.

In September 2008, the supreme operational body of the IMF, the *Executive Board* reviewed one of the most important roles of the organisation, bilateral surveillance. They concluded, among others, that due to the unfolding crisis, more attention must be pair to macroeconomic congruencies than before. A detailed methodology guideline[10] was issued for IMF associates to help surveillance consultations.

Not much later, in October 2008, the IMF's executive board defined the priorities[11] to be applied in bilateral surveillance during the coming three years. Naturally, similar priorities already existed before, although they were not specified in a formal statement. The executive board emphasised that with a view to the higher-than-usual uncertainty of the situation, the priorities might be reviewed and fine-tuned before the end of the scheduled three-year period if necessary. The declared priorities can be classified into two groups. The first includes economic priorities which were deemed necessary for returning economies to a sustainable, non-inflationary growth track. The second group includes technical, operational priorities set for IMF associates.

Economic priorities to be followed include

the following. Regarding the *Alleviation of tensions in the financial system*, restore the stability of the financial system and minimize the negative impact of the crisis of financial markets on the real economy. Regarding the *strengthening of the global financial system,* develop cross-border surveillance and regulation, especially in large financial centres; protect capital importing countries, including low-income countries against the impact of excess exposures. Regarding the *dampening of large price fluctuations in commodity markets,* seek responses to these price fluctuations which are compliant with the domestic environment while being globally consistent, alleviate the inflationary pressure during booms and limit the risks of a price dive. Regarding the *facilitation of the organised mitigation of global imbalances,* strive for the simultaneous decrease of adverse real economy and financial linkages.

In cooperation with other international financial institutions, the IMF was ready to take a leading role in promoting a common understanding of the linkages behind these challenges, in shaping an opinion and drawing key lessons across its membership. Besides, the IMF undertook to provide clear, advance warnings of risks to global economic and financial stability and advise on economic policy measures, in particular monetary, fiscal, exchange rate and financial sector policies in support of these objectives.

The following operational priorities were underlined. Regarding *risk assessment,* refine the related tools so that clear early warnings can be provided to member countries; more thorough and more systematic analyses are needed concerning risks to *base line scenarios;* where reasonable, low probability but high-cost risks and their economic policy impact must be analysed as well. Regarding *financial sector surveillance and real-financial linkages,* improve analysis of financial stability, including diagnostic tools; deepen understanding of linkages between markets and institutions; and ensure adequate discussion during bilateral surveillance and in surveillance reports. Regarding multilateral perspective, systematically take into consideration inward and (where appropriate) outward spillovers in the course of bilateral surveillance; it is also advised to observe relevant lessons learnt in other countries. Regarding the *analysis of exchange rates and external stability,* develop the risk analysis of the latter and therefore special attention must be paid to currency exchange rates within the analyses of various economic policy aspects, which in turn calls for the development of methodology toolsets. At the same time, continued attention must be paid to the traditional key areas of IMF analyses, in particular to fiscal policy and the sustainability of external debt.

At the Washington summit of G-20 countries in October 2008, internationally harmonised measures and a specific action plan was agreed upon. The IMF was assigned a significant role both in preparing analyses to identify necessary measures, examining their expected effects and in keeping track of measures taken by individual countries. Then in order to reverse increasingly negative trends and to overcome the crisis which deepened in the meantime and heavily affected the real economy, agreements of decisive importance were finally made at the London G-20 summit held on 2 April 2009.

In the official communiqué[12] released on the summit, the leaders of the 20 key countries of the world declared that they regard prosperity undividable and not an objective for developed countries only. Therefore, in order to make it sustainable, growth must be divided and not only the interests of living generations but that of future generations must be taken into consideration as well. The leaders emphasised that *sustainable globalisation and increasing prosperity can only be built on the solid foundation of an*

open world economy which is based on market principles, effective regulation and strong global institutions. Participants declared their commitment to take measures that are necessary to restore growth and jobs, and to do it explicitly in a manner that does not hazard the sustainability of fiscal balance in the long run.

At the summit, the G-20 group undertook to make all efforts to restore confidence, growth and jobs; restore the financial system to restart lending; strengthen financial regulations to restore confidence; reinforce international financial institutions and their financing in order to overcome the current crisis and avoid similar ones in the future; reject protectionism and foster global trade and investments in order to lay the foundation of prosperity; and to achieve inclusive, green and sustainable stabilisation.

The leaders agreed to carry out further harmonised government action in addition to formerly taken significant measures. The G-20 summit requested the IMF to assess regularly the measures taken to restore growth and identify additional steps that are needed on a global basis. They emphasised that they support the honest and independent bilateral surveillance activities of the IMF which measures all countries equally..

At the regular general meeting of the IMF held in late April 2009, the executive board confirmed that the IMF undertakes the pivotal role in keeping track of and assessing measures taken against the crisis and integrated this commitment into the IMF's work plan. In early June 2009, the IMF released a detailed assessment[13] of the impact of the extraordinary and harmonised government interventions of previous months, complete with an outlook and proposed additional actions.

In that study, IMF specialists emphasise that the global financial crisis exercises a severe impact on the financial position of most countries. Fiscal revenues decrease, direct financial support must be provided to the financial sector and many countries employ unique financial stimulus to mitigate the effects of global recession. All this has an adverse influence on general government finances.

The detailed analysis looked at the direct costs of the crisis in specific countries, partly through direct support provided to the financial sector and through government guarantees and similar commitments. Both government and central bank subsidies were taken into consideration and the net medium-term cost of interventions was calculated. Furthermore, calculations were prepared regarding the costs of the recession. Besides the calculated output gap, the impact of certain additional external factors were taken into account (e.g. stock market prices, housing market prices, commodity exchange prices, profitability in the financial sector, exchange rate and interest levels) along with the costs of certain economic stimulus interventions that are based on specific government decisions. The third set of calculations revealed the investment losses of pension systems and its impact on the budget. Based on the detailed calculations, conclusions were drawn on the short and long-term outlooks of fiscal balance, including risk analysis.

Due to the different characteristics of individual countries, results were slightly different for developed and emerging economies within the G-20 group. Researchers found that fiscal balance deterioration was especially strong in developed countries where both government debt and guarantee-like *contingent liabilities* expanded rapidly. What aggravates the situation is that long-term imbalances had existed already, especially in countries with a quickly aging population.

In the medium term, the improvement of the fiscal balance was considered likely but it was not thought to reach the pre-crisis level. According to the calculations of IMF specialists, the average public debt-to-GDP ratio of

developed countries within the G-20 group (which deteriorated by nearly 20 percentage points compared to the end of 2007) would continue to deteriorate in the coming years. At the same time, the experts found that short and medium-term financial risks increased due to the crisis both in advanced and emerging countries.

Three especially significant adverse risks were identified: further support may need to be provided for the financial sector; the setback of output may be intense and lasting; and the size of potential revenues from the sale of assets nationalized through the provision of financial support during the crisis is questionable.

Based on the calculations, the rather gloomy financial outlook raises the possibility of budget insolvency in some cases which may trigger unfavourable reactions on the market. IMF specialists consider the avoidance of insolvency threats very important as *market confidence in the solvency of governments is a prerequisite of stability and economic recovery.* (Or else the budget cannot be financed.) Therefore, the IMF believes it is very important that national governments prepare a clear strategy on avoiding the risk of insolvency.

Regarding future perspectives, IMF specialists highlight to interrelated questions. First, if the economic outlook continues to deteriorate, what is the "elbow space" for further fiscal policy measures? Second, how markets can be convinced that the solvency of a government is not at risk? IMF experts do not quantify the allowed extent of subsidies, they apply a risk management method instead. They conclude that not all countries have a room in their budget for economic stimulus packages. Governments facing this situation must weigh to opposite risks. One is the risk of prolonged depression and stagnation. From this respect, the economic and financial cost of "no action" may even exceed that of a potential intervention. Therefore, the government may choose to provide support even at the expense of further budget deterioration – especially in the financial sector which plays a decisive role in financing but potentially by directly stimulating aggregate demand. The other main risk, however, is the loss of market confidence in the sustained solvency of a country. Amidst unfavourable global economic conditions, the deteriorating financial position of the general government is natural. However, in order to avoid intolerable risks, key indicators (e.g. real interest rate, interest margin, debt expiry structure) must be monitored closely. The weaker these indicators become, the narrower is the room for fiscal intervention.

It is quite difficult to find a balance between these two opposite risks. This is why IMF specialists consider it very important t*hat governments come up with credible and transparent strategies for sustaining solvency in order to avoid any loss of confidence.* According to experts, this strategy must rely on the following four pillars:

- Where the sustaining of fiscal stimulus packages is reasonable, these packages should be designed in a way that they do not lead to permanent deficits. Fiscal stimulus packages should consist mainly of temporary measures.
- Policies should be cast within medium-term fiscal frameworks that rely on clearly specified economic policy principles and a supporting institution system, thereby confirming government commitment to carry out a gradual fiscal correction once economic conditions improve. Permanent monitoring must be provided for all along the way.
- In order to enhance growth, structural reforms are needed.
- In countries exposed to extensive demographic pressure, there should be a firm commitment and a clear strategy to contain the trend increase in aging-related spending.

IMF specialists emphasize that the proposals outlined in the study are not new. Some of the

have been part of the IMF's economic policy recommendations for long. However, calculations show that with general governments being in a weaker financial position, failure to see through the necessary measures would lead to much higher additional costs.

Concerning economic stimulus packages, it was recognised earlier that these packages are expected to be left in place for a longer period of time because the setback of demand in the private sector is likely to last long. However, the authors of the staff position note emphasize that these packages must not be launched as permanent measures which lastingly deteriorate the budget position. In an ideal case, what is needed is a shift over time that, with respect to the pre-crisis baseline, raises deficits for the expected duration of the crisis and reduces them later, so as to leave long-run debt levels unchanged. It is important therefore that stimulus measures are self reversing or at least affect a set period of time. The examination of economic stimulus measures of individual countries found that by far not all actions compiled with the aforementioned criteria. This is why the IMF study proposed that governments should draw up a clear plan as soon as possible on how they intend to deactivate the economic stimulus measures in the medium run.

Perhaps it was partly due to the criticism voiced by the IMF but definitely a sign of the organization's professional reputation that the G-8 group (consisting of the 7 most advanced countries and Russia) officially requested[14] the IMF in the middle of June 2009 to prepare an analysis of the possible ways of gradually eliminating the extraordinary government measures that were taken to combat the crisis.

The IMF urged the adoption of medium-term fiscal frameworks because the setting of 4–5 year credible goals would help reveal vulnerabilities. IMF experts point out that the credibility of these targets is more important than ever and therefore the targets must be backed up with the specification of clear and firm economic policy measures. The IMF found that not all countries do so even if they apply medium-term frameworks.

In order to capture fiscal risks, medium term frameworks must address the manageability of government debt under different scenarios. This analysis is considered especially important in the current situation where the volume of guarantees undertaken by governments increased significantly in many countries. IMF specialists urge countries to put effective and transparent measures in place to maximize revenues from management and recovery of assets acquired during the financial support operations. Regarding support provided by central banks to financial institutions, experts point out that central banks must be promptly reimbursed for their losses incurred on these operations through transfers recorded as expenditures in the government's budget.

Concerning fiscal rules, IMF experts are of the opinion that these rules can help maintain or restore solvency if they rely on adequate political commitment, if they are sufficiently flexible to take extraordinary circumstances into consideration and if they are designed and applied in a way that avoids excessive constraint on economic policy. According to the IMF, whether or not formal rules are introduced, *governments should express their commitment to tighten fiscal policy in good times, now that fiscal policy had to be relaxed during bad times.*

At their Pittsburgh summit held on 25 September 2009, the G-20 expressed their opinion that the IMF should continue to play a coordination role and further develop surveillance activities. In this context, the IMF's supreme economic policy body, the IMFC (International Monetary and Financial Committee) set action items[15] in four main areas at their general meeting held in Istanbul, Turkey in October 2009. First of all, the man-

date of the IMF must be revised and the exercise should strive for covering all macroeconomic and financial sector issues that relate to global stability. In agreement with the point raised by the G-20 group, bilateral surveillance must be transformed in a way that focuses on the joint assessment of the economic policy of individual countries. Also on the request of the G-20 group, the IMF quotas (financial commitment and voting ratios) were changed in favour of currently underrepresented emerging countries. At the same time, building on the initial success of the newly introduces flexible credit line and taking into consideration the limited resources of the IMF, it must be examined how the IMF as a "last resort" lender could provide loans to even more countries in extraordinary situations so that national governments could settle with keeping lower foreign currency reserves themselves.

The overcoming of the crisis was a key topic at the annual ministerial meeting of the OECD held in June 2009. The member countries agreed to make all efforts to overcome the global financial, economic and social crisis which evolved due to major failures in the financial sector and in regulation and surveillance.[16] To this end, they expressed their support of further harmonised efforts of OECD member countries. They emphasised that *recovery plans must also address the social and human dimensions of the crisis by* supporting the most vulnerable groups of societies with active employment policy measures, training programs, skills development, income support, effective social safety nets, etc. The declared purpose of these measures is to avoid long-term unemployment growth triggered by the crisis. In the course of these actions, special attention is to be paid to young and relatively old workers. The lesson drawn from former experiences is that measures that reduce labour supply are fruitless or rather counterproductive. Therefore, preference is given to actions that expand labour supply in the long run.

The ministers attending the meeting expect the many extraordinary financial, monetary and fiscal policy measures taken already to restore market confidence and to cushion the adverse impact of the crisis in activity and employment. In its areas of responsibility, the OECD undertook to participate in the analyses of the potential ways of unwinding the extraordinary measures taken in response to the crisis so that the world economy can return from a policy-driven recovery to a self-sustained growth.

Notes

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