Sustainability of Public Finances in Times of Crisis

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Abstract. *In the face of crises like the COVID-19 pandemic, this article delves into the pressing need for governments to sustainably manage public finances amid economic and social turbulence. It underscores the pivotal role of fiscal sustainability during such periods of upheaval, emphasizing its significance in stabilizing budgets and fostering enduring economic recovery. By scrutinizing various fiscal strategies and policies, the article seeks to elucidate pathways towards maintaining budgetary stability while simultaneously facilitating sustainable growth. It highlights the importance of prudent financial management in navigating through tumultuous times, where the resilience and adaptability of public finances become paramount. Through an examination of effective fiscal measures, the article aims to provide insights into how governments can address immediate challenges while laying the groundwork for long-term fiscal sustainability. Ultimately, it advocates for a comprehensive approach to financial governance that prioritizes resilience and sustainability in times of crisis, thereby fortifying economies against future shocks.*

Keywords: Economic Crisis, Budget deficit, Public Debt, Austerity Measures, Economic Recovery Policies

1. Introduction

The sustainability of public finances, also known as fiscal sustainability, refers to a government's ability to maintain its current spending, tax policies, and other commitments in the long term without risking insolvency or defaulting on debts. This concept is crucial for ensuring the continuity of essential public services and supporting long-term economic recovery. The recent crisis highlighted the importance of fiscal sustainability, emphasizing its impact on intergenerational equity and the functioning of economies. Maintaining control over public debt, the capacity to issue debt securities when necessary, and the ability to adapt to unforeseen circumstances are key aspects of ensuring fiscal sustainability. The European Commission defines public finance sustainability as the government's ability to sustain its current policies without jeopardizing solvency or defaulting on liabilities. Various countries and research institutes assess fiscal sustainability through reports that analyze adjustments needed in fiscal policies to ensure sustainability. The concept of fiscal sustainability is complex, with different studies using varying definitions and criteria to evaluate it.

In this context, the deterioration of fiscal-budgetary positions and the increase of public debt in the EU since 2008, as well as the budgetary pressures generated by the aging of the population amplify each other and turn fiscal-budgetary sustainability into an acute political challenge. Starting in 2014, the weights public debt to GDP have started to fall at the EU aggregate level. However, the legacy of the crisis means that the public debt burden remains high in several EU countries.

Analysis of potential public debt developments and risks to fiscal sustainability is therefore crucial for euro area countries and the EU as a whole to be able to formulate appropriate policy responses aimed at strengthening fiscal solvency when necessary.

Recent developments, in particular the sovereign debt crisis, which have made market access more difficult for certain EU countries, have confirmed that fiscal sustainability challenges are not only manifested in the long term. It is essential that budgetary reserves are replenished in time to absorb new shocks as they occur; last but not least, we can expect an increase in interest rates.

In the euro area and in the EU more generally, the overall fiscal outlook continues to improve, the share of the deficit in GDP is projected to decrease to 1.1% in the euro area and 1.2% in the EU in 2017 and to maintain this trend until 2019, when it is projected to reach 0.8% in the euro area and 0.9% in the EU. As deficits have decreased and/or experienced favorable "snowball" effects, the debt-to-GDP ratio has been on a downward slope since 2014, both in the euro area and in the EU. It is expected to reach 89.3% in the euro area and 83.5% in the EU in 2017 and to further decrease to 85.2% and 79.8% in 2019. This improved outlook on debt levels of the public sector is supported by nominal GDP growth and the level of interest rates, which has reached a historic low. However, current and future economic and budgetary situations vary widely across EU countries. The appropriate mix of policies needed to ensure fiscal sustainability therefore varies as much depending on the challenges with that each country faces.

The sustainability of public finances, also known as fiscal sustainability, is crucial for governments to maintain their spending, tax policies, and overall financial health without risking insolvency or defaulting on liabilities. Factors influencing fiscal sustainability during crises include the impact of fiscal policies on government balance sheets, the ability to rebuild fiscal buffers for future shocks, and the role of public finance professionals in managing resources effectively. Public finance institutions and revenue administrations also play a significant role in ensuring sustainable public finances. Research on topics like transfer pricing provides valuable insights into enhancing fiscal sustainability.

The Organization for Economic Co-operation and Development (OECD) highlights the importance of achieving sustainable public finances and managing government debt, especially post-crisis. Fiscal sustainability involves maintaining public finances in a credible and serviceable position over the long term. Many OECD countries are facing challenges due to rising public debt-to-GDP ratios since the financial crisis, necessitating significant efforts to reduce debt levels. Strategic forecasting is crucial for adapting financial planning to future revenues and socio-economic trends. Countries like Greece, the United Kingdom, and the United States require substantial increases in primary underlying balances to reduce public debt. OECD member countries have implemented fiscal consolidation plans equivalent to over 5.5% of GDP, with varying sizes and compositions across nations. Sound strategic forecasting should consider demographic changes and growing budgetary pressures due to aging-related expenditures. The sustainability of public finances depends not only on public debt levels but also on taxes and effective government policies. The European Commission emphasizes the impact of the financial and economic crisis on public finances and stresses the need for sustainability measures.

2. Crisis Impact Assessment

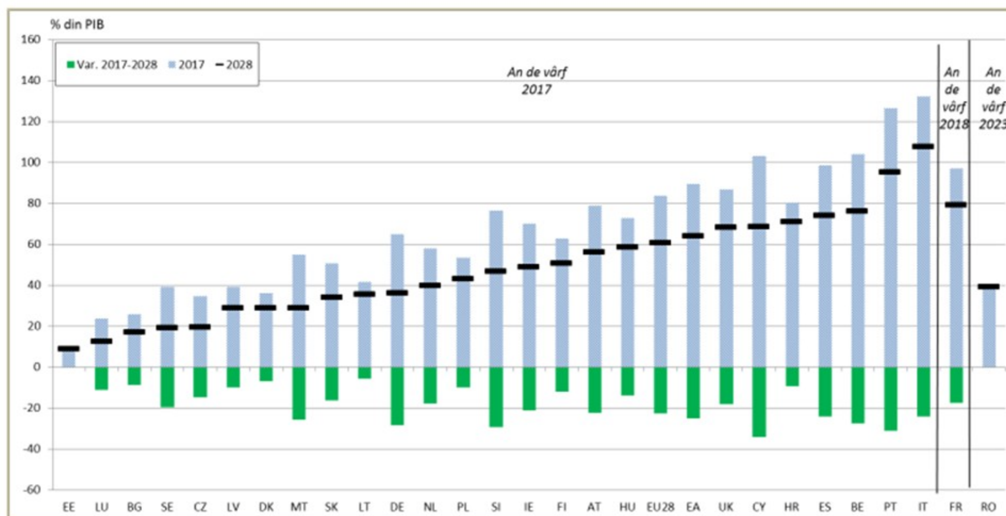
The analysis emphasizes the importance of assessing the impact of crises on public finances, highlighting reduced tax revenues, increased social spending, and the necessity to allocate resources for economic stimulus as key challenges to budgetary sustainability. When evaluating fiscal sustainability, it is crucial to consider both the current and potential levels of public debt. Countries with high levels of debt are more

susceptible to economic downturns and interest rate shocks. Without a sufficiently high primary surplus, maintaining public debt sustainability can be challenging, even without an aging population. A high public debt level can jeopardize fiscal sustainability, irrespective of the long-term costs of population aging.

The literature on fiscal and debt sustainability offers various approaches, from simple concepts like the debt stabilizing primary balance to more complex frameworks aiming to determine optimal debt levels within welfare-maximizing contexts. Assessing debt sustainability involves examining the reaction of fiscal policy to rising debt levels and deriving debt benchmarks through illustrative scenarios based on reasonable assumptions about growth and interest rate shocks in different economies. Strategies for including macroeconomic uncertainty in fiscal sustainability assessments are crucial for a comprehensive understanding of the challenges faced by governments in managing public debt effectively.

In 2017, more than half of EU member states had a public debt-to-GDP ratio above the 60% treaty threshold. However, if Member States were to fully comply with the fiscal rules in the SGP - in other words, in the SGP scenario - it would be expected that in 2028, virtually all states would have a lower debt ratio compared to a scenario in the which the fiscal-budgetary policy would not undergo any change (figure 1). Furthermore, assuming full compliance with the fiscal-budgetary rules in the SGP, no member state would see increases in its debt-to-GDP ratio until 2028.

PSC scenario



The reference scenario in which the fiscal-budgetary policy would not undergo any change

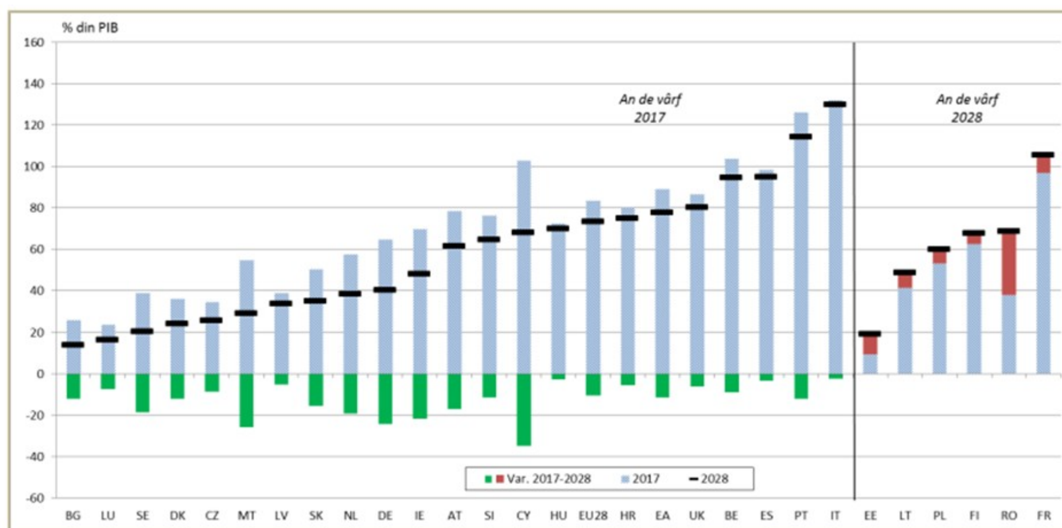


Figure 1. Projections of gross public debt in the PSC scenario compared to the no-fiscal-fiscal-policy reference scenario (% of GDP)

Crisis Impact Assessment is a critical process that evaluates the potential impacts of a crisis on various aspects such as infrastructure, human health, livelihoods, and security. This assessment is crucial for improving crisis management throughout the overall crisis lifecycle, including the prevention, response, and recovery phases. It involves field-based assessments, post-crisis needs assessments, post-crisis environmental assessments, business impact analysis, and the use of rapid environmental impact assessment tools. The assessment helps in prioritizing the needs of rehabilitation and quantifying direct physical damage in infrastructure, as well as in identifying major environmental risks and providing recommendations to national authorities on how to address them.

3. Responsible Fiscal and Budgetary Policies

Responsible fiscal and budgetary policies play a crucial role in ensuring economic stability and growth by influencing macroeconomic conditions through government spending and tax policies. Fiscal policy involves adjusting tax rates and government spending to impact aggregate demand, employment, inflation, and economic growth. The implementation of fiscal consolidation measures, effective budgetary adjustments, and the elimination of wasteful spending are essential tools for maintaining sustainability. In the United States, fiscal policy is directed by both the executive and legislative branches, with key figures like the President, Secretary of the Treasury, and the Congress playing significant roles in shaping fiscal policies. Additionally, during times of crisis, a medium-to-long-term strategy that addresses fiscal vulnerabilities while fostering sustainable growth is crucial for economic recovery and stability.

Fiscal policies play a crucial role in economic growth, macroeconomic stability, and inflation. Key aspects include government expenditure, revenue, budget deficits, and government debt. Fiscal discipline is essential for stability, especially in a monetary union like the euro area. The EU has institutional arrangements to ensure sound fiscal policies, such as the prohibition of monetary financing, privileged access

to financial institutions, and bail-out clauses. The Stability and Growth Pact provides guidelines for budgetary surveillance and coordination among Member States to maintain macroeconomic stability and low inflation. Governments use fiscal policy, involving government spending and taxation, to influence the economy positively. During crises like the global economic downturn, fiscal policy becomes crucial in supporting financial systems, promoting growth, and reducing poverty. Fiscal tools can provide a boost to the world economy by adjusting spending, taxes, and borrowing levels.

The European Union has established various institutional arrangements to ensure sound fiscal policies and macroeconomic stability. These arrangements include:

- Prohibition of monetary financing, privileged access to financial institutions, and bailouts (Articles 123, 124, and 125 of the Treaty on the Functioning of the European Union).
- Fiscal provisions to avoid excessive government deficits (Article 126) and the excessive deficit procedure.
- The Stability and Growth Pact, which defines procedures for budgetary surveillance and conditions to avoid excessive deficits.
- The fiscal compact within the Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union, which mandates a balanced budget rule at the national level.

These measures aim to promote fiscal discipline, prevent unsustainable public finances, and contribute to economic stability within the EU.

The Excessive Deficit Procedure (EDP) is a key aspect of the European Union's budgetary policy, aiming to ensure that member states avoid excessive government deficits. According to the Treaty establishing the European Community, countries must adhere to reference values for the general government deficit (3%) and gross debt (60%) in relation to GDP. The decision on whether a member state is in an excessive deficit situation is made by the ECOFIN Council based on a proposal from the European Commission. The EDP involves steps to be taken if a country is deemed to have an excessive deficit, potentially leading to sanctions. The procedure includes reporting government deficits and debt levels to the European Commission, with specific deadlines for data submission. The process also incorporates the Stability and Growth Pact (SGP), which outlines measures for countries to follow in case of non-compliance with deficit and debt limits.

Reforms in 2005 relaxed the rules of the SGP, maintaining the 3% deficit and 60% debt ceilings but introducing parameters like the behavior of cyclically adjusted budgets and debt levels to determine excessive deficits. The EDP aims to guide member states towards fiscal sustainability through coordinated economic and budgetary policies.

The Stability and Growth Pact (SGP) is an agreement among all 27 European Union member states aimed at maintaining economic stability within the Economic and Monetary Union. It establishes fiscal rules to prevent countries from overspending, with key provisions including limits on budget deficits not exceeding 3% of GDP and national debt not surpassing 60% of GDP. The SGP functions through coordinated budgetary policies, aiming to ensure sound budgetary practices on a permanent basis by requiring member states to adhere to medium-term objectives close to balance or in surplus. Failure to comply with the rules can result in fines up to 0.5% of GDP. The Pact plays a crucial role in achieving macroeconomic stability, low inflation, low interest rates, sustainable economic growth, and job creation within the EU.

Diversification of income sources is a key strategy. Increasing the efficiency of tax collection, attracting investment and exploring public-private partnerships can bring much-needed additional resources. Diversification of revenue sources is a key strategy in ensuring the financial sustainability of a country and reducing the risks associated with dependence on particular revenue sources.

Diversifying income sources offers several benefits, including increased revenue, reduced risk, and enhanced financial stability. By creating multiple revenue streams, businesses can demonstrate their ability to weather economic downturns, attract investors, and reduce dependence on any single source of income. However, income diversification also comes with challenges, such as the need for constant monitoring, evaluation, and optimization. Various strategies for diversifying income include investing in stocks, real estate, and bonds, exploring new business ventures or partnerships, and expanding product lines. Revenue diversification is essential for the growth and sustainability of businesses, as it reduces risks and makes companies more resilient, especially during tough times. By incorporating revenue diversification, businesses can increase their chances of maintaining profitability regardless of market conditions.

4. Investment in Health and Education

Investments in health and education are crucial for sustainable development as they significantly enhance the quality of life, human capital, and societal equity. Prevention programs, such as vaccination campaigns and healthy lifestyle education, are key in reducing diseases and promoting overall health. Building and upgrading healthcare facilities with modern equipment ensures access to quality healthcare services and enhances diagnostic and treatment capabilities. Investing in health infrastructure transformation towards community-based care, improving access to affordable healthcare, reducing health inequalities, and supporting the up-skilling of the health workforce are essential priorities for sustainable health systems. Investing in education is an investment in health as it can help lower employers' healthcare costs by improving health outcomes through better education. Education funding can act as a counterbalance to rising healthcare costs by enhancing health outcomes, leading to savings for businesses and improved workforce productivity. The economic implications of a healthier, more educated workforce go beyond healthcare spending, contributing to increased employment rates, reduced economic assistance needs, higher tax revenues, and a stronger economy overall.

These findings emphasize the critical role of investments in health and education in fostering sustainable development by not only improving individual well-being but also contributing to economic growth and societal well-being investment in health human resources, including attracting and training health professionals, is essential. A well-trained health workforce contributes to improving the quality of health services. Investing in health and education is crucial for societal development. Health investments can improve the overall well-being of the population by enhancing access to quality healthcare, reducing health inequalities, and promoting social cohesion. Similarly, investments in education play a vital role in developing human capital, which is a significant driver of economic growth and stability. Education not only equips individuals with essential skills but also contributes to better health outcomes, leading to potential cost savings for businesses and society as a whole. By prioritizing funding for medical research, school infrastructure, teacher training, educational technologies, scholarships, vocational programs, and inclusive education, societies can ensure sustainable economic growth and an improved quality of life for all.

Investing in education and healthcare is crucial for a country's overall growth and development. Education serves as the foundation for economic progress by providing individuals with the necessary skills for the modern economy, fostering innovation, and increasing productivity. Similarly, healthcare plays a critical role in economic growth by ensuring a healthy and productive population, reducing disease burdens, and improving overall health outcomes. Moreover, these investments can positively impact poverty reduction by breaking the cycle of poverty through education and improving health outcomes. Additionally, education and healthcare contribute to reducing inequality by providing equal opportunities for success regardless of background, promoting social mobility. Ultimately, by prioritizing education and healthcare, countries can create a more prosperous, equitable society for all.

Investing in education and healthcare is crucial for a country's growth and development. Education is fundamental for economic progress, fostering innovation, productivity, and workforce participation. Similarly, healthcare plays a vital role in enhancing productivity by ensuring a healthy population that can actively engage in the workforce. These investments not only boost economic growth but also aid in poverty reduction by equipping individuals with the necessary skills and improving health outcomes. Moreover, education and healthcare contribute significantly to reducing inequality and promoting social mobility by providing equal opportunities for all individuals. By prioritizing education and healthcare, countries can create a more prosperous and equitable society, leading to long-term benefits for their populations all.

5. The Role of Government Social Responsibility

The social responsibility of government is crucial in promoting sustainability. Governments have a responsibility to ensure transparency, involve citizens in decision-making processes, and manage resources efficiently. These actions help build trust and support sustainable fiscal policies. By fulfilling these responsibilities, governments can create a fair, just, and sustainable society. Government has a responsibility to protect the fundamental rights of citizens, including the rights to life, liberty and property. This involves enacting and implementing laws to ensure justice and equality before the law.

The role of governments in promoting corporate responsibility involves various objectives such as promoting corporate social responsibility (CSR) activities in businesses, engaging the private sector in development, and fostering responsible business practices. Governments can promote corporate responsibility through awareness-raising efforts, partnerships, soft law approaches, and mandating instruments to monitor and enforce corporate accountability. This approach emphasizes the importance of responsible business practices in sustainable development and highlights the need for collaboration between governments and businesses to address social and economic challenges effectively.

The role of government in promoting corporate social responsibility (CSR) is crucial and multifaceted. Governments can mandate, facilitate, and endorse CSR through legislation and regulation, setting standards in areas like environmental protection, health, safety, and employment rights. They also raise awareness, collaborate with private industries, provide economic incentives, and encourage the tightening of standards across various sectors. This comprehensive approach aims to ensure that businesses integrate social and environmental concerns into their operations, fostering better CSR practices and contributing to sustainable and responsible business conduct.

The discussion on shaping the future emphasizes the importance of understanding current trends and technological advancements to anticipate and prepare for future challenges and opportunities. Key issues in shaping the future include analysing economic, technological, social, and environmental trends to assess possible development directions. Technology plays a crucial role in shaping the future, with emerging technologies like artificial intelligence (AI), biotechnology, and information technologies impacting various sectors. These technologies are poised to revolutionize industries by enhancing creativity, collaboration, and innovation. Additionally, sustainable and renewable energy technologies are becoming increasingly vital in addressing global energy needs due to concerns over climate change and resource depletion. Investments in renewable energy solutions are driving down costs, improving efficiency, and promoting energy conservation for a more sustainable future.

The evolution of culture and social changes significantly impact society's norms and values, shaping future behaviours and attitudes. Understanding and modelling these aspects are crucial for anticipating future developments. Identifying potential risks like cyber threats, climate change, and geopolitical challenges is essential for building a secure and resilient future. Citizen involvement through public consultations, surveys, and participation in decision-making processes is key to identifying community priorities and needs. Modelling the future involves creating frameworks and scenarios to aid decision-making and preparation for upcoming changes, emphasizing collaboration among governments, communities, the private sector, and researchers.

6. Conclusions

The sustainability of public finances is crucial for the long-term stability of a country's economy. It refers to the ability of a government to maintain its current spending, tax, and other related policies without threatening its solvency or defaulting on its liabilities or promised expenditures. The recent crisis has highlighted the importance of fiscal sustainability, which affects intergenerational fairness and embodies principles that apply to all governments, regardless of their current indebtedness.

To ensure the sustainability of public finances, a fine balance must be struck between fiscal consolidation and strategic investments. Fiscal consolidation involves reducing government spending and increasing revenue to improve the budget balance and reduce public debt. Strategic investments, on the other hand, involve spending on long-term projects that can contribute to economic growth and development. Adopting responsible fiscal policy and engaging citizens can help build a sustainable financial foundation for the future. This can be achieved by implementing structural reforms, improving fiscal governance, and promoting transparency and accountability in public finances. By doing so, governments can contribute to sustainable economic and social development, ensuring that future generations have access to the resources and infrastructure they need to thrive.

The sustainability of public finances, also known as fiscal sustainability, is crucial for governments to maintain their current spending, tax policies, and other commitments without risking insolvency or defaulting on liabilities. It is a fundamental concern that impacts intergenerational fairness and the overall economy. Governments must manage debt levels effectively to ensure economic stability and the ability to respond to unforeseen events like economic crises. Fiscal sustainability involves principles that are essential regardless of a government's current debt levels.

Measures such as maintaining the capacity to issue debt when necessary, adjusting to economic fluctuations, and implementing structural reforms are vital for ensuring sustainable public finances.

Post-COVID fiscal adjustments present significant challenges for many countries due to high fiscal deficits and unprecedented public debt levels. Countries will need to undertake substantial fiscal consolidations, as monetary policy may not be able to support the economy with high inflation and tightening cycles. External factors like rising global interest rates, food and energy crises, and geopolitical tensions will further constrain policy space and increase the need for larger consolidations. The simultaneous need for fiscal consolidations globally could potentially depress global demand.

Policymakers facing slow-paced fiscal consolidations may need to navigate challenges to prevent significant short-term output losses and inequality deterioration. For Low-Income Developing Countries (LIDCs) and small Emerging Markets (EMs), this approach could free up resources to address COVID-19 pandemic impacts, invest in social sectors, infrastructure, and climate initiatives. However, the feasibility of gradual consolidation hinges on factors like available financing, external support, debt restructuring, and policymakers' commitment to reform.

In the context of prolonged consolidations and heightened uncertainty, policymakers must be wary of reform fatigue and external shocks. Countries with high debt levels and vulnerability to shocks risk losing market confidence, necessitating a delicate balance between restoring credibility swiftly and minimizing output losses through more immediate consolidation measures. To exert more control over the process, policymakers should enhance the credibility of fiscal plans early on, reinforce medium-term fiscal frameworks, establish contingency plans, and strengthen institutional foundations to sustain reform efforts.

A combination of expenditure and revenue measures is crucial for post-COVID fiscal consolidations due to their significant scale. The specific balance between revenue and expenditure adjustments should be tailored to each country's circumstances. Countries with substantial government size may focus on reducing current expenditure, particularly on wages and transfers, while safeguarding social spending and public investment to support poverty reduction and long-term growth. Nations with low current revenue levels should prioritize revenue mobilization to address not only fiscal consolidation but also long-term challenges like poverty reduction, climate change, and population aging. Implementing growth-friendly revenue-raising strategies such as reducing tax expenditures, increasing property taxes, and adjusting consumption taxes like VAT, excise duties, and environmental taxes can be beneficial. Additionally, in cases requiring debt restructuring to restore fiscal sustainability, early engagement with creditors is advised to facilitate access to international capital markets and minimize economic downturns.

A well-designed fiscal adjustment program should consider economic and political dynamics, as well as the strength of a country's institutions. Evidence suggests that public and political support is crucial for the success of fiscal consolidation programs. Engaging with key stakeholders early and regularly can aid in implementing such programs effectively and enhancing their quality. Communication is vital in these programs, especially in volatile times, to clarify objectives, expected impacts, and mitigation policies, which can bolster confidence in policymakers' commitment to managing public finances responsibly.

The success of fiscal consolidations often requires a combination of expenditure and revenue measures. While spending-based adjustments may lead to smaller output losses than tax-based ones in some cases, revenue-raising measures can be less

contractionary for Low-Income Developing Countries (LIDCs). Large consolidations typically necessitate a mix of tax and spending measures to stabilize debt permanently. Genuine structural reforms are essential for balancing consolidation, equity, and long-term growth goals effectively.

Fiscal consolidation programs should encompass well-integrated structural reforms and capacity development support to enhance fiscal institutions. These reforms aim to boost revenue, enhance expenditure efficiency, and are crucial when fiscal space is limited. Additionally, focusing on product and labor market reforms can aid in resource allocation and stimulate private sector activity. Capacity development should commence early, be well-sequenced with a medium-term perspective, and aligned with reforms to strengthen budgetary and tax institutions, particularly emphasizing core Public Financial Management (PFM) functions along with revenue administration.

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