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Unintended Consequences of Fiscal Governance Rules on the Long-Term Financial Position of State Governments.

ABSTRACT

Fiscal governance rules are viewed as prudent tools that promote balanced budgets, lower tax burdens, and ensure modest use of long-term debt. However, these rules can create incentives that inadvertently worsen the government's long-term financial position. Focusing on unfunded retiree benefits and long-term debt, this study finds that states subject to political balanced-budget requirements report higher unfunded pension benefit obligations and higher debt burdens. In contrast, anti-deficit provisions and limits on taxing authority are associated with lower unfunded retirement benefits. Findings suggest fiscal rules can worsen a government's long-term financial position in ways not visible in the operating budget.

Summary

- Virtually every state has adopted fiscal governance rules to limit economic actors and ensure prudent management of resources.
- These rules are often presumed to have the intended impact on government finances, including promoting balanced budgets, lowering tax burdens, and restraining long-term borrowing.
- This study finds that fiscal rules can worsen a government's long-term financial position in ways not visible in the operating budget.
- The effectiveness of any fiscal governance framework depends on how it shapes policymakers' perceived costs of deviating from desirable policies.
- Findings highlight the need to reassess fiscal rules to ensure they support sustainable long-term financial management rather than merely short-term budget balance.

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Public Budgeting. & Financing

by Sharon N. Kioko

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