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Top-Down Budgeting Today[1]

Introduction

Top-down budgeting (TDB) is a budgeting mechanism the core feature of which is the use of aggregate expenditure ceilings to guide budget preparation. It has operated successfully for many years in the Netherlands (since 1994), Sweden (1997), Switzerland (2001), Finland (2003) and Denmark (2012). Historically, a key source of inspiration for TDB was the "new control totals" system of aggregate expenditure ceilings introduced in the United Kingdom in 1992 (but long abandoned there).[2]

Over the past decades, TDB has seemingly gained a wide following internationally. Quite a few advanced countries indicate in OECD surveys that they use aggregate expenditure ceilings (Moretti, Keller and Majercak, 2023). International organizations actively promote TDB (IMF, 2024; OECD, 2025). Significant numbers of developing countries also now use what they call ceilings in their budget preparation processes.

There is, however, a problem. The countries that pioneered TDB had, and still have, a clear common understanding of what it means — an understanding based on a specific view of the nature and role of aggregate ceilings. However, many of the other countries that supposedly use ceilings do not share that understanding of their nature and role and do not have TDB systems in the sense understood by the pioneers. What these other countries mean by "ceilings," and the role they assign to them, varies considerably.

Without clarity about the basic concepts, it is not possible to have a useful discussion about the merits of TDB, its design, and the circumstances under which it works. In the light of this, the first part of this note clarifies the original meaning of TDB and its concept of aggregate ceilings. The initial application of aggregate ceilings to reduce, or prevent the growth of, the size of the state is outlined.

This is followed, in the second part of the note, by an extended discussion of how TDB handles upward spending pressures.

In the third and final part of the note, the focus shifts to the contrast between the original model of TDB and the way it is supposedly practiced in many countries today. Particular attention is paid to the widespread contemporary phenomenon of so-called "indicative ceilings." This leads to a discussion of the conditions under which true TDB can work and the best methods for making it work.

[1] The author thanks Frits Bos and Philipp Krause for valuable comments on a draft of this note. The ideas set out here benefited from discussions with finance officials in many countries over the years — most recently with officials of the Ministerio de Economía y Finanzas de Peru and the Fiscus team (Andrew Lawson and Gonzalo Álvarez de Toledo) during technical collaboration on top-down budgeting funded by the Swiss Government.

[2] On the new control totals, see Thain and Wright (1995) and National Archives (2005).

Annexes cover several more detailed issues, including the relationship of TDB to expenditure rules, a "golden rule" version of TDB, and the specification of aggregate ceilings in accrual terms.

Throughout this note, "ceilings" refers – unless otherwise explicitly stated – to *aggregate* expenditure ceilings.

1. What is Top-Down Budgeting?

The use of aggregate expenditure ceilings is what defines TDB. Under TDB, ceilings are set during the initial "strategic" phase of budget preparation.[3] They cover most[4] government expenditure and are expressed as amounts for specific years. (For example, the expenditure ceiling in Sweden for 2026 was SEK 1,866 billion.) Budgets are prepared that authorise, for the categories of spending covered, amounts of expenditure up to the ceilings. During budget execution, mechanisms such as contingency reserves are used to ensure that the ceilings are respected.[5]

An essential part of the original conception of TDB is that ceilings are essentially *unchangeable* after the strategic phase of the budget preparation process. They are never increased during the subsequent phase of the process — in which ministry budgets are elaborated — to accommodate more spending requests. They cannot be increased at that stage even by deciding to implement offsetting tax increases. The only changes to ceilings that might be permitted are those resulting from pre-defined and strictly limited technical factors, such as updated revenue forecasts. Ceilings are therefore not bargaining positions. They do not represent an initial offer to spending ministries that the Ministry of Finance expects to increase during subsequent budget negotiations.

Any budgeting system that uses aggregate ceilings in this way is a TDB system in the original sense of the term.

Defining TDB based exclusively on the use it makes of *aggregate* expenditure ceilings — as this note does — means declining to accept the proposition that TDB necessarily requires the specification during the strategic phase of *ministry* (or sector) expenditure ceilings. The final

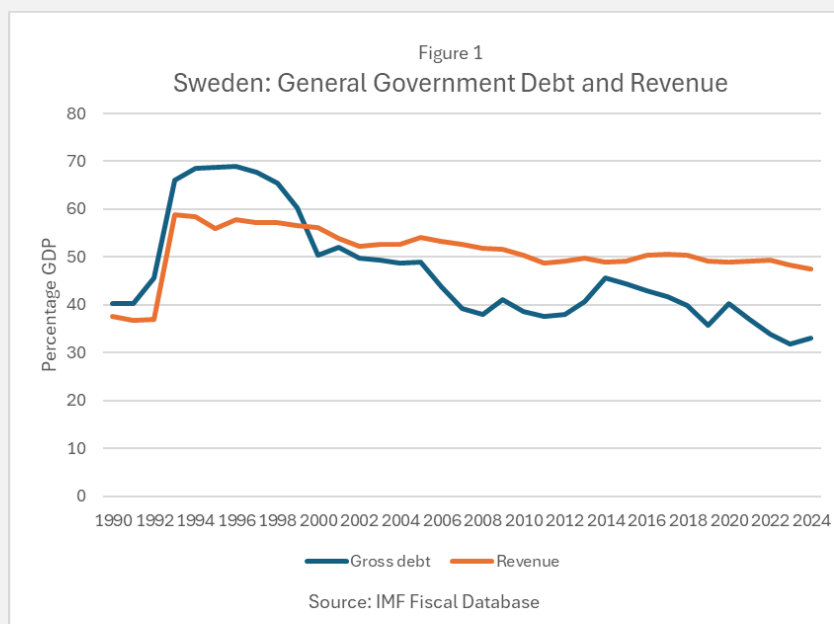
[3] The strategic phase is the initial stage of budget preparation when the Government plans broad budget strategy, and that finishes when the Ministry of Finance issues the budget circular and invites spending ministries to prepare their budget proposals.
[4] In all TDB systems, some significant categories of expenditure, such as interest payments and unemployment benefits, are excluded from the ceilings. These are categories of expenditure that cannot be controlled by imposing numerical limits because they increase or decrease without any decision on the part of government, usually as the result of the provisions of standing laws or contracts. This makes them similar to revenue, which is mainly determined by tax laws.
[5] Contingency reserves are used to offset any unanticipated urgent or uncontrollable spending that might otherwise push spending above the ceiling. The ceilings may nevertheless be breached during exceptional crises (like a grave recession or the pandemic).

part of this note discusses the reasons for this and considers how aggregate ceilings are best divided between ministries.

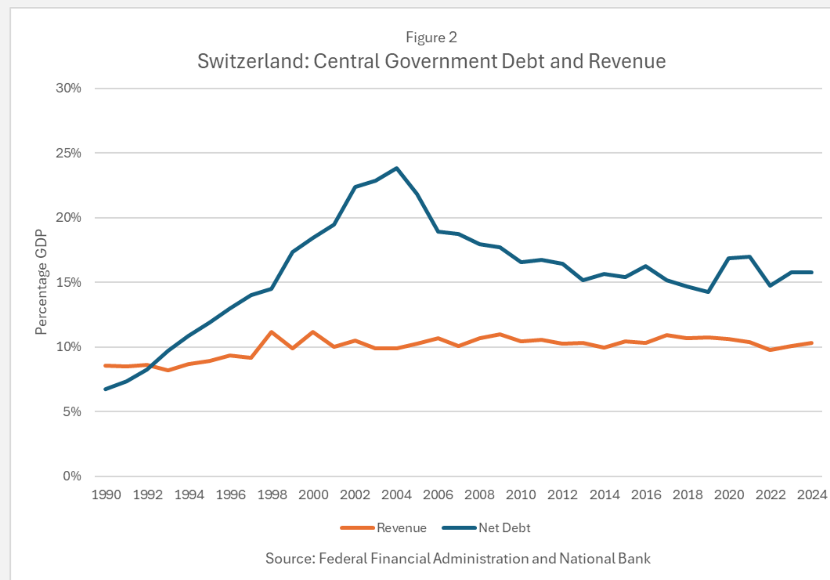
Ceilings are typically set and applied for each year over the medium-term budget planning horizon. Annex 1 illustrates this with a numerical example. It makes the point that the unchangeable nature of aggregate ceilings during budget preparation has nothing to do with the separate question of whether the outer year ceilings in a medium-term framework are "indicative" or "fixed."

The Function of Aggregate Ceilings

Separating tax and expenditure decisions through the use of unchangeable ceilings is central to the original concept of TDB. This is because, under TDB as practiced in the pioneer countries, aggregate expenditure ceilings are an instrument with a specific purpose — namely, to facilitate the simultaneous pursuit of objectives for the overall budget balance[6] (as a means of reducing or stabilising debt/GDP) *and* for the level of taxation. This purpose was clear from the beginning. Sweden introduced TDB at a time when there was deep concern about the country's high levels of debt and taxes. It used ceilings with great success to gradually reduce both (Figure 1). The Netherlands did the same after introducing its top-down budgeting regime at a time when debt, deficits and taxes were all seen as having gone far too high (Adema, n.d.). In Switzerland, TDB was applied to progressively lower historically high central government debt without recourse to tax increases (Figure 2). For these governments, to have focused exclusively on the budget balance would not have been enough, because they were also focused on what happened to the tax level. TDB was, in short, developed and initially applied as a tool to implement gradual fiscal consolidation focused on the expenditure side.



[6] In this note, "budget balance" always refers to the overall budget balance unless specifically indicated otherwise – e.g. as the current, primary or operating balance.



Fiscal circumstances are different today. There are stronger upward spending pressures, and containing aggregate spending is a much more challenging task. TDB remains, arguably, as relevant as ever. The new fiscal environment has, however, created challenges for TDB that require an appropriate approach to the setting and application of ceilings. This is discussed further below.

Whatever the fiscal circumstances, ceilings prevent governments from taking an unduly accommodating approach to spending requests put forward during budget preparation. TDB does this by procedurally separating decisions about ministry spending requests from decisions about the tax take.

The antithesis of TDB is bottom-up budgeting. This describes a budgeting system where, during the consideration of spending ministry budget requests, there is no constraint on the amount of spending that the government may approve. The sheer volume of funding requests is, under these circumstances, hard for the Ministry of Finance to process. Given the extent of spending pressures from interest groups and spending ministers, it is easy for the government to go too far in acceding to ministry spending demands. Bottom-up budgeting thus tends to be too "expenditure-driven" (Ljungman, 2009). It creates a bias towards rising expenditure, debt and taxes — a bias that TDB aims to counteract by imposing the discipline of aggregate expenditure ceilings.

Proponents of TDB consider that setting stringent objectives for the budget balance is insufficient to resolve the problems created by bottom-up budgeting. Even if the budget balance objective is respected, the upward expenditure and tax bias remain. But an unduly accommodating approach to spending requests also increases the risk that the government will end up breaching its budget balance objectives because it is unable to say "no" to many spending demands.

It will be clear that TDB can only fully block the upward pressure on expenditure from bottom-up requests if it is not possible — even by raising taxes — to accommodate additional ministry

spending requests by increasing ceilings. This is why ceilings must be unchangeable after the strategic phase of budget preparation. They may incorporate the impact of decisions to change taxes, but only if these tax changes have been decided before the completion of the strategic phase.

Counteracting the bottom-up budgeting bias is not the only benefit derived from the imposition of ceilings. Ceilings also promote allocative efficiency by forcing governments to make decisions about expenditure priorities within a hard budget constraint.

How Aggregate Ceilings are Determined

Although the pioneer countries are not all entirely transparent about the way in which they determine their ceilings, the principle is clear. In essence, ceilings are the amount governments can afford to spend given their budget balance objectives and chosen revenue policy stance.

In the pioneer countries, ceilings are framed in the light of demanding objectives for the structural[7] overall budget balance. These objectives are set well before the ceilings are determined and are intended to be stable over at least the medium term. For example:

- In Sweden, the budget balance objective is set every eight years. This practice started when the TDB system was introduced, with a 2 percent surplus target covering the period 1997-2006 (Grevesmühl and Aström, 2025).
- In Switzerland, TDB was introduced following a popular vote that added a balanced budget rule requirement to the constitution.
- In Denmark, the 2012 Budget Act that introduced TDB set a target maximum deficit of 0.5 percent (Nielsen and Rasmussen, 2012).[8]

These structural budget balance objectives provide the *fiscal anchor* in the context of which ceilings are set. Once the budget balance is taken as a given, any given level of expenditure requires a specific level of taxes, and vice versa. Expenditure must be consistent with the *revenue policy stance*.[9]

An essential feature of TDB is that the expenditure ceilings reflect an explicit early decision, taken during the strategic phase of the budget preparation process, on the revenue policy stance. In other words, when the government decides the expenditure ceilings it also decides the appropriate level of taxes. This is a key element of what the Dutch refer to as the strict

[7] "Structural" means cyclically-adjustment and the exclusion of windfall revenues. As is commonplace in advanced countries irrespective of whether there is a TDB system, the budget balance objective is cyclically adjusted to stop spending rising (or taxes being cur) during the upswing of the business cycle, when revenue is temporarily higher. It thereby blocks the "ratchet" effect this can have on aggregate spending (because new spending initiatives introduced during the upswing are hard to cut back when the economy turns down and revenues fall).
[8] The 0.5 percent deficit limit stood until 2022, when the law was amended to raise it to 1 percent.
[9] Government does not budget by deciding the amount of revenue it will receive. Instead, it decides on its revenue policy stance — the set of taxes and charges it will apply — and the amount of revenue raised is a function of that revenue policy stance.

separation of the revenue and expenditure sides of the budget (Beetsma et al, 2010).[10] It contrasts with bottom-up budgeting, where the revenue policy stance may only be finalised at the end of the budget preparation process after all the expenditure decisions have been made.

In setting out the implications of this, expositional clarity is helped by making the simplifying assumption that ceilings cover *all* government expenditure. While this is not true,[11] it makes no material difference to the analysis.

On this basis, the essence of TDB may be captured by the formula

$c \leq r(\rho) - b^*$.

Where c is the aggregate ceiling, r is structural revenue (which is a function of the revenue policy stance ρ) and b^* is the standing constraint on the structural budget balance — all expressed as percentages of GDP. The two variables c and ρ are jointly determined given the value of b^*. (For simplicity, we will replace the ≤ with an equal sign in what follows, because although ceilings are in practice sometimes set a little below the level indicated by this equation, this is for reasons that are not consequential for the analysis.[12])

Switzerland applies a particularly simple and transparent version of this principle, in which ceilings equal structural revenue (DFF, 2023) – i.e., c = r. Because Swiss fiscal policy is based on the objective of a structurally balanced budget ($b^* = 0$), a value for the budget balance objective does not need to appear in the formula.

Ceilings are, then, not determined arbitrarily. In the pioneer countries, they are formulated using a tough budget balance objective as a fiscal anchor. Within the constraints of this fiscal anchor, they reflect the government's choice with respect to the tax level.

The pioneer countries thus do not derive their expenditure ceilings from expenditure rules. Ceilings are not expenditure rules – notwithstanding the confusion on this matter in some of the literature. This raises the question of whether it might be possible to set ceilings based on expenditure rules — even though this is not what the pioneer countries do. The answer is that this is possible only under limited circumstances. Basing ceilings on expenditure rules does not provide an alternative TDB model with wide applicability. The relationship between ceilings and expenditure rules is discussed in Annex 2.

Are there other alternative approaches to setting aggregate ceilings in a TDB system? One option is a TDB system based on the golden rule of public finance, which means excluding capital expenditure from the aggregate ceilings. This would not, however, represent a radically

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[10] Which in the context of the Dutch system of fixed multi-year ceilings goes even further, with additional revenue measures in subsequent years of the multi-year period banned.

[11] The categories of spending that excluded from ceilings are part of aggregate expenditure and influence the budget balance and debt. They therefore need to be factored into the determination of ceilings, and to be managed in order to meet the objectives for the budget balance and the level of taxation. This raises a range of technical issues (Ljungman, 2008, 2009; Robinson, 2015). However, issues concerning the coverage of ceilings are not material to the questions addressed in this note.

[12] For example, when ceilings are set for the outer years in a fixed medium-term framework such as that of the Netherlands and Switzerland, they represent not so much the initial ceiling calculation but rather the outer-year extrapolation of the expenditure and tax decisions taken for the entire period within the constraints of the multi-year ceilings.

different approach to TDB, because it would still use a budget balance objective — for the current or operating balance — as the fiscal anchor in the context of which ceilings would be set. This option is discussed later.

Top-Down Budgeting and the Size of the State

Using expenditure ceilings to manage the level of taxes while achieving demanding budget balance objectives makes them an instrument with which to manage the size of the state. The level of ceilings chosen must correspond, whether explicitly or implicitly, to a view of the appropriate size of government. As the Swedish government put it, "a meaningful limit to expenditure has to start in some way from an overall concept of how the public sector should relate to GDP." (Regeringskansliet, 2011: 27).

TDB was originally developed as an instrument to contain or reduce the size of the state. To achieve this, it aimed to change budgeting from mainly expenditure-driven to mainly revenue policy-driven. The model was one in which the relationship between decisions on the tax level and decisions on the size of government expenditure would operate mainly in one direction, with objectives for the level of the tax burden determining the size of the state's expenditure imprint.[13] The belief that it was possible to put revenue policy objectives into the budgeting driver's seat was bolstered by a perception that there was, at the time, plenty of expenditure fat that could be cut either to reduce taxes or to respond to spending pressures without increasing aggregate expenditure.

It is possible in this context to distinguish two alternative approaches to the determination of ceilings, each of which was designed to serve different objectives with respect to the size of the state. The distinction between them hinges on the treatment of, firstly, the revenue yield given an unchanged revenue policy stance ("baseline" revenue) and, secondly, any change in the revenue yield due to the modification of the revenue policy stance (e.g., changes in tax rates or the introduction or elimination of taxes).

The first approach is to determine ceilings based on the assumption of an unchanged revenue policy stance. In this approach to setting ceilings, if r_b represents baseline revenue/GDP, the formula is simply $c = r_b - b^*$. This approach effectively aims to maintain the size of the state constant.[14] The Swiss method for determining ceilings is a version of this.[15]

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[13] This was clear in the Swedish government view that "since in the long run it is the level of the expenditure ceiling that determines the total tax take, the level should be decided so that it corresponds with the view of how large a reasonable tax take can be without incurring excessive macroeconomic costs" (Regeringskansliet, 2011: 27).

[14] If government expenditure is maintained over time at the level of the ceilings, the results is that expenditure/GDP remains approximately constant assuming, as it typically the case in advanced countries with a diverse revenue base, that revenue on an unchanged policy basis grows at approximately the same rate as GDP.

[15] Noting once again that in the Swiss model the *d* disappears because of the structural balance budget objectives.

The second approach to determining ceilings is to decide on any change in the revenue stance during the strategic phase of the budgeting process and then factor it into the expenditure ceilings. Under this approach, the formula for determining the expenditure ceilings is:

$$c = r_b + \Delta r - b^*$$

Where Δr represents the change in revenue due to the revenue policy modification decided when the ceiling is set (i.e., $r(\rho) - r_b$).

This was the model for setting ceilings used in Sweden from the outset of the TDB regime (Brussewitz and Lindh, 2005). It was specifically designed to downsize the state, because the inclusion of the term Δr served as a vehicle for explicitly including planned tax cuts in the determination of the ceilings. This is why Δr — which would here have a negative value — was referred to at that time in Sweden as the “tax reform” factor.

In what follows, this latter approach will be referred to as the *ex-ante adjustment approach* to setting ceilings.

2. Top-Down Budgeting and Spending Pressures

In most countries, budgeting cannot — other than temporarily — be exclusively or mainly driven by revenue policy. Revenue and expenditure are two sides of the same coin. While expenditure decisions should take into account the need to limit the tax burden, tax decisions should also reflect expenditure needs. It is a two-way street.

This is particularly true today, when upward spending pressures, including in areas such as defence and health, have become intense (Robinson, 2020). Any notion of downsizing the state seems, under current circumstances, unrealistic. For most OECD countries, even keeping the state from growing is extremely challenging. In preparing their budgets, governments are more than ever obliged to consider whether there is sufficient fiscal space to respond to spending pressures and, if not, to consider raising additional revenues. The era in which TDB could focus on downsizing is with us no longer.

Powerful upward spending pressures have, in recent times, led in some pioneer countries to a certain loosening of the constraints imposed by TDB. This has been happening in two ways: the exclusion of a wider range of spending from the ceilings[16] and the easing of the budget balance objectives that feed into the determination of ceilings.[17]

Current circumstances nevertheless make the case for TDB stronger rather than weaker. If they can be designed and implemented properly, aggregate expenditure ceilings can help considerably in managing upward spending pressures.

[16] TDB systems generally include escape clauses allowing certain additional expenditure to be excluded from the ceilings under grave emergencies, and these clauses have in recent times been used more liberally (e.g. in relation to defence expenditure).
[17] Denmark has, for example, shifted from targeting a 0.5 percent deficit to a 1 percent deficit.

The case for TDB is even clearer in countries that have excessive debt and tax levels that are already so high that every effort should be made to avoid raising them even further. For such countries, the appropriate form of TDB is, at the technical level, simple. Aggregate ceilings should be set on the assumption of an unchanged revenue policy stance and a tough budget balance objective — broadly on the Swiss model — with the intention of gradually reducing debt/GDP while preventing the tax burden from growing further. This would oblige government to fund high-priority new spending exclusively via cuts to existing spending programs. In practice, of course, such a fiscal strategy is usually politically very difficult.

For countries that have scope to raise taxes, TDB is technically more complicated in the face of intense spending pressure. It requires either adjustment of expenditure ceilings to cope with those pressures or a mechanism for overriding the ceilings in a controlled manner. We discuss each of these possibilities in turn.

Spending Pressures and the Ex-Ante Adjustment of Ceilings

The ex-ante adjustment approach to setting ceilings, as outlined above, is one in which ceilings are adjusted at the time they are set to incorporate the impact of any change in the revenue policy stance (the factor Δr). This approach can – and is – used in TDB systems not only to factor planned tax cuts into ceilings, but also to adjust them for the impact of expenditure policy changes that require tax increases.

In the Netherlands, for example, ceilings are set for multi-annual periods when new governments assume office. The ceilings are explicitly adjusted for the costs of expenditure policy changes agreed to in the coalition negotiations that always precede the formation of the government. If the expenditure policy changes require tax increases, these increases are decided when the ceilings are set. Δr then has a positive value. This respects the TDB principle by ensuring that any changes to the revenue policy stance take place during the strategic phase of the budget preparation process before individual ministries present their budget proposals (Bos, 2007).

Under the ex-ante adjustment approach, then, the appropriate response to major spending pressures is to incorporate into the process of setting expenditure ceilings a mechanism to decide how much additional space to include within the ceilings for high-priority new spending and make any necessary revenue policy changes. This requires a very well-developed strategic phase in the budget preparation process. It is during this phase that the government should consider its overall priorities, look at the spending pressures it faces and assess the scope for major savings in baseline expenditure. The outcome of these deliberations should, in principle, be aggregate expenditure ceilings that are adequate to fund high-priority new spending, but which also incorporate as far as possible selected savings in baseline spending to help fund such additional spending. Independent forecasts and fiscal analysis – of the sort provided in the Netherlands by the Central Planbureau, and elsewhere by fiscal councils – can reinforce the integrity of the process.

This is what almost all countries with TDB systems have done when needed. It is simple in principle, but less simple in practice. A major challenge is how to create such a mechanism

without re-introducing, by the back door, the problems of bottom-up budgeting that TDB is designed to address. There is a real risk that spending ministries will respond to such a system by shifting their lobbying for larger budgets to the strategic phase. To avoid this, considerable effort needs to go into the institutional design of the strategic phase to keep it focused on the big picture. It is essential to limit deliberations during this phase to selected areas of spending that have been carefully pre-designated as high-pressure. It may also be useful to reserve the power to make the necessary adjustments to the aggregate ceiling to a cabinet sub-committee which excludes most spending ministers. Extensive analytic support by the Ministry of Finance is crucial. The precise nature of the appropriate institutional mechanisms will, however, depend on the political system.[18]

An option that may be worth considering is the use of separate sub-ceilings within the aggregate ceiling for certain high-pressure spending areas such as health and defense. This may help counter the risk that increasing the ceilings to cope with spending pressures in specific areas has the undesirable spillover effect of reducing the pressure to contain spending in other areas.[19] (Note that such a proposal is unrelated to the proposition that TDB requires that the aggregate ceiling be decomposed into ministry or sector ceilings during the strategic phase.)

This ex-ante adjustment approach has a major implication for the design of *spending review*, conceived in its original sense of the systematic review of baseline expenditure to identify savings options (Robinson, 2013a). It makes it crucial that the main output of spending reviews is available to government during the strategic phase of budget preparation, when savings options can be used to offset, at least in part, the cost of high-priority new spending. Savings options that are presented at a later stage, after the aggregate ceilings have been set, may be less useful if TDB operates in this manner.

Spending Pressures and the Swiss Approach

For most countries, the ex-ante adjustment approach of setting ceilings that take into account spending pressures is the only potentially workable form of TDB. However, it is not the only method for dealing with spending pressures in a TDB system. The Swiss Confederation has a different approach. Essentially, this requires expenditure ceilings to be set based on unchanged revenue policy, as outlined earlier. The budget preparation process is then carried out with every effort to respect these ceilings. If this is found to be impossible because of major spending pressures, the government is legally obliged to prepare an adjustment program (Enlastungspaket/Programme d’allégement) comprising some mix of expenditure-side changes and tax increases to comply with the basic rule of a structurally balanced budget. The

[18] The importance of the political system is illustrated by the case of the Netherlands, where ex-ante adjustment remains a disciplined process in large measure because it is confined to expenditure policy changes included in the coalition agreement.
[19] Excluding such areas from aggregate ceilings would, by contrast, make little sense. As with any other exclusions from coverage of ceilings, it would be necessary to take into account expected expenditure on these areas when setting the aggregate ceilings. Because this requires making a decision about these levels of spending during the strategic phase of budget preparation, there would be no point in excluding them from the ceilings.

Parliament then votes on the adjustment program. This process takes place infrequently — most recently in the preparation of the 2026-28 multi-annual budget.[20]

This system works only because of the Swiss political system, which is one in which it is hard to increase federal taxes and no federal government is in a position to formulate a budget on the confident expectation that it will succeed in legislating significant tax increases.[21] This ensures that a very serious effort is made to comply with expenditure ceilings based on unchanged revenue policy and to avoid, if possible, recourse to an adjustment program.

Any spending increases above the ceilings are, in this system, not upward *revisions* of the ceilings. They are *breaches* of the ceilings and therefore do not violate the TDB principle that ceilings must not be revised upwards during budget preparation. Such breaches cannot be considered failures of the Swiss TDB system, because the possibility that these will occur is explicitly recognized and procedures laid down for handling this eventuality. Swiss budgeting remains firmly top-down, notwithstanding this built-in recognition of the possibility that the final approved budget will exceed the ceilings.

The Golden Rule

Before concluding the discussion on managing upward spending pressures under TDB, mention should once again be made of the option of shifting to a fiscal regime based on the golden rule of public finance and adapting TDB accordingly. For countries where a move to a golden rule regime would be feasible, the rule would be helpful in handling the major capital expenditure pressures that many face today in areas such as defense and climate change. A TDB version of the golden rule would provide greater flexibility for capital expenditure by excluding it from the aggregate ceilings. The golden rule is, however, only a viable fiscal policy model in countries where the debt level is low or moderate. These issues are discussed in Annex 3, with accounting aspects addressed in Annex 4.

3. Top-Down Budgeting Today

It is easy to get the impression that TDB is widely practiced today. In many developing countries, the MOF now sets “ceilings” in the budget circular. Most OECD countries supposedly also use ceilings (OECD, 2025).

Appearances are, however, deceiving. It is difficult to determine, with available information, exactly how many countries have adopted TDB in the sense the term is understood in the

[20] For the 2026-28 multi-year budget, this was the consequence of the perceived need for a major increase in defence expenditure combined with the need for increased government funding of the pension system arising from a referendum that had made the system more generous.
[21] The federal government typically does not have a level of control over the parliament that guarantees that it will be able to force tax increases through without substantial political consensus. Moreover, a significant degree of popular acceptance is necessary because significant tax increases can – and often are – be challenged via referendum.

pioneer countries. There are a few countries – such as Singapore and Chile – where this is certainly, or very probably, the case. But many of the assertions made in the literature about advanced countries that apply TDB are inaccurate. Countries that have never used ceilings – such as Australia,[22] the United States,[23] Norway and New Zealand – are incorrectly said to do so.[24] Countries that had TDB systems at some stage in the past – such as Korea and the United Kingdom – are also sometimes counted as part of the TDB fraternity when this is no longer the case. As for developing countries, it seems extremely doubtful that many do in fact have TDB systems.

A key source of confusion about the prevalence of TDB is that the term "ceilings" has come to be used in several senses that have little to do with the original meaning of the term. This is seen both in country practice and in some of the TDB literature and manifests itself in relation to aggregate expenditure and ministry expenditure.

In one version of the concept, aggregate "ceilings" refer to aggregate expenditure projections in medium-term budget frameworks, even when these projections do not serve as constraints either during the preparation or execution of the budget and the MTBF is a paper exercise to which no one pays much attention.

In another version of the concept, "ceilings" refers to the final budget allocations given to ministries at the end of the budget preparation process. Examples of this include:

- The proposition that, in a budget preparation process which starts with ministry baselines, the "ceilings" are the final budget allocations that result when these baselines are adjusted in negotiations with spending ministries (Dorotinsky and Watkins, 2013).
- The mischaracterisation of the multi-year allocations given to ministries in the United Kingdom (the Departmental Expenditure Limits) as expenditure ceilings, notwithstanding that the DELs are determined only after consideration of budget requests from ministries.

Indicative "Ceilings"

Of greater relevance, however, is another version of the concept of ceilings that is widespread today. This is the concept of "indicative" expenditure ceilings, meaning allocations that are set at the beginning of the budget preparation process and are then open to upward adjustment in subsequent negotiations with ministries. This concept is used with reference to both aggregate expenditure[25] and ministry allocations. (This use of "indicative" has, it is important to note,

[22] The use of medium-term estimates of baseline expenditure in the Australian budget process is not the same as the use of expenditure ceilings.
[23] The spending limits established by the Congressional budget resolution – and then broken into 302(b) allocations – are not established prior to the consideration of agency budget proposals and therefore do not qualify as expenditure ceilings in the TDB sense.
[24] See, for example, Dorotinsky and Watkins, 2013; KIPF, 2005: 111; OECD, 2025: 49, 53.

[25] Costa Rica, Japan, Korea and Luxembourg all claim to set indicative aggregate ceilings (OECD, 2025: 50).

nothing to do with the separate question of whether outer year ceilings in a medium-term framework are indicative or fixed.)

It should be obvious that an "indicative" ceiling that can be adjusted upwards during budget negotiations is not a ceiling at all. It is more a floor than a ceiling and can more accurately called an *indicative allocation*.

The origins of the concept of indicative ministry ceilings lie in a common misconception about the fundamental nature of TDB. This is that TDB necessarily requires the setting, during the strategic phase of the budget preparation process, of ministry ceilings as well as aggregate ceilings and that, like aggregate ceilings, the ministry ceilings must not be open to change during the remainder of the budget preparation process. This is what may be called the "hard ministry ceilings" doctrine. It can be found peppered throughout the PFM literature.

Several TDB pioneer countries purport to set hard ministry ceilings. The others do not. The crucial point, however, is that in *most* other countries that have tried to implement the hard ministry ceilings doctrine, it has not worked. While it is easy enough for the MOF to announce ministry "ceilings" in the budget circular, making these ceilings stick in the face of spending ministry and political pressures has usually proven to be impossible. Faced with this reality, most would-be TDB countries have quickly abandoned any attempt to insist that the ministry "ceilings" are not open to negotiation and have shifted to the indicative model.

The move to setting indicative ministry "ceilings" does not appear to have been useful in most countries, because the "ceilings" do little or nothing to constrain bottom-up spending pressures. Spending ministries generally do not hesitate to demand large increases over their indicative ceilings, and substantial upward adjustments are common.[26] This is hardly surprising because, in many countries, the indicative ceilings are just the first move in a bargaining game. What happens is that the MOF, knowing in advance that it will have to raise its offer at a later stage, deliberately proposes indicative ceilings that are unrealistically low. The spending ministries respond with demands that they know to be unrealistically high. The two sides then settle somewhere in between. In such a bargaining game, it also makes sense for the Ministry of Finance to play its cards close to its chest by not revealing the true aggregate expenditure ceiling (if there is one). This is very different from practice in the pioneer TDB countries, where the aggregate ceilings are always explicit.

Why Ministry Ceilings (Usually) Don't Work

Why is it so difficult to make hard ministry ceilings work? No type of ceiling — aggregate or ministry — is, of course, going to work unless there is a political willingness to discipline spending. But even if there is a real commitment to fiscal discipline, it is no easy matter to set ceilings and then refuse to make any adjustments whatsoever to them.

[26] For example, the increase in the 2024-25 indicative ceiling of the Pakistan Higher Education Commission from Rs25 billion to Rs65 billion after the HEC demanded Rs126 billion (*Business Recorder,* 5 June 2024).

The first difficulty is political. The Minister and Ministry of Finance have to be extremely powerful — and to have the total backing of the Prime Minister or President — to be able to brush off all spending ministry demands for additions to their ceilings. They have to be able to fight off even the most powerful spending ministers and interest groups. This is a big ask.

The other difficulty is technical. If ministry ceilings are to stick, they have to be credible, and not either arbitrary or obviously unreasonable. However, in most countries the MOF finds it challenging to undertake – without having any of the information that spending ministries might include in formal budget proposals – the extensive analysis of spending needs that would be necessary to be able to set ministry ceilings sufficiently credible to avoid being immediately subject to many entirely legitimate challenges. The technical difficulty in setting credible ministry ceilings greatly contributes to the political difficulty of making them stick.

Even in countries where MOF technical capacity is high and there is a well-designed strategic phase of the budget preparation process, it is very challenging to set ministry ceilings that are sufficiently responsive to changing spending priorities and pressures without formal and structured input from spending ministries. Attempting to do so runs a high risk of allocative rigidity.

It can therefore be said that, whatever a country's circumstances and capacity, the hard ministry ceilings doctrine does not make sense and is certainly not an essential element of TDB. As Kraan (2017) puts it:

> *The expression "top-down budgeting" has given rise to various misunderstandings. The first is that it means that line ministries are not allowed to put forward budget requests before the Ministry of Finance has announced the caps. This would not be rational. The budget process must allow the opportunity for trade-offs between spending programmes in different ministerial portfolios, as well as for trade-offs between spending programmes and tax measures. It also ought to provide line ministries with a fair hearing where they can argue their case. Furthermore, it would be practically impossible to deny them such opportunity. Attempts in this direction simply push the process behind the scenes and lead to agreements without the benefits of a structured process.*

The experience of Singapore is relevant here. The successful Asian city-state initially implemented a version of TDB in which the aggregate ceiling was split into hard ministry ceilings during the strategic phase – what it referred to as the "block budget system." It quickly realized, however, that this system unduly reduced "flexibility for the Treasury [i.e., MOF] to reallocate resources as priorities change." As a consequence, it moved in 2004 to a system in which there is a pool of unallocated money for distribution between ministries during the budget preparation process in response to rising spending needs or innovative projects. This was achieved by giving indicative allocations to spending ministries that add up, in total, to less than the aggregate ceiling, thereby leaving the unallocated amount (Low, n.d.).

Making Indicative Ministry Allocations Work

Making indicative allocations to spending ministries while leaving an unallocated amount within the aggregate expenditure ceiling for distribution based on spending ministry requests – as Singapore does – provides not only a degree of allocative flexibility, but also a safety valve to cope with some of the pressure that a system of hard ministry ceilings would typically be unable to contain. However, to prevent all of the problems of bottom-up budgeting resurfacing, a number of steps have to be taken to limit spending ministry requests for shares of the unallocated amount.

First and foremost, it is crucial that spending ministries are made to understand that it is difficult to obtain amounts in excess of their indicative allocations and that there is a high probability that they will need to live with those allocations. Ministries cannot be expected to accept this unless their indicative allocations are credible. This means that the indicative allocations must have a logical relationship to their spending requirements, and cannot be lowball amounts proposed in a bargaining game.

The best way of achieving this is by taking ministry *baselines* as the starting point for determining the indicative allocations. This not only creates a clear relationship between the indicative allocation and spending requirements, but also immediately significantly reduces the number of potential requests for shares of the unallocated amount by excluding requests for additional baseline funding. With baselines funded exclusively from indicative allocations, requests for additional funding can be limited to new spending initiatives.

To suggest that indicative allocations should be derived from ministry baselines is not, however, to say that ministries should simply be given all of their baselines. If there is to be an unallocated amount after the indicative allocations are made, the sum of indicative ministry allocations must be less than the aggregate ceiling. This may require the indicative allocations to be set somewhat below baselines. Further reductions in the indicative allocations may also be required to create the fiscal space for any major decisions about new spending priorities taken in the strategic phase. As discussed earlier, in a well-developed TDB system, every attempt needs to be made during the strategic phase to identify and respond to major spending pressures and priorities. If this leads to increases in the indicative allocations of certain ministries,[27] it may be necessary to partly or wholly offset these by cuts to the baselines of other ministries.

If indicative allocations need to be pruned for these reasons, this may be done by across-the-board mechanisms such as "productivity savings" or, for more significant savings, spending review.

This suggests, in summary, that indicative ministry allocations decided during the strategic phase should be *adjusted baselines* and that they should sum to an amount less than the

[27] For example, a decision taken during the strategic phase to increase defence expenditure over time from 2 percent to 3 percent of GDP would translate directly into an increased indicative allocation for the Ministry of Defence.

aggregate ceiling so as to leave an unallocated amount the disposition of which is decided during the later phase of the budget preparation process.

Several further steps should also be taken to contain requests for shares of the additional funding from the unallocated amount. Tough information and procedural requirements for the presentation and consideration of new spending proposals are essential. The way in which spending requests are handled in practice needs to be such that spending ministries come to understand that frivolous demands for additional funds have a near-zero chance of succeeding. Also helpful is clear guidance on government priorities for the budget. Finally, spending ministries should have the option of self-funding new spending initiatives by making compensatory cuts in their own baselines – and they should be encouraged to use that option as far as possible.

In summary, although indicative *ceilings* are a contradiction in terms, a TDB system based on indicative *allocations* can make perfect sense if it is designed properly. Indicative allocations should nevertheless not be confused with ceilings.[28]

This is merely an outline sketch of how aggregate expenditure ceilings might best be applied in many countries. The detailed processes required necessarily vary depending on national characteristics, including features of the relevant administrative and political systems.

Conclusion

Top-down budgeting has been highly successful over the past decades in the countries where it was pioneered. In those countries, it has proven its value in helping to bring down debt levels while containing or reducing taxes. This is an impressive achievement given the disarray of public finances in many other advanced countries.

The intensity of today's spending pressures makes the successful operation of top-down budgeting more challenging. At the technical level, however, many of the methods for dealing with these pressures are clear. As everywhere, the biggest challenge is political, not technical.

Adoption of the golden rule of public finance, and a version of top-down budgeting based on it, can potentially help handle certain major spending pressures – but only in countries where debt is at sustainable levels.

In recent decades, the meaning of top-down budgeting has become distorted. "Ceilings" have come to mean a range of different things, one of which is "indicative" allocations that are upwardly adjustable. Indicative allocations are, however, not ceilings. The confusion has arisen largely as a result of failed attempts to apply the "hard ministry ceilings" doctrine – that is, to set ministry ceilings that cannot be adjusted upwards.

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[28] The degree of confusion on this that can be seen in some of the literature is exemplified by the statement that "in most [TDB] countries, the overall expenditure ceiling is adjusted to finance new policy initiatives at the latter stage of the budget process" (Kim and Park, 2006).

Although indicative allocations are not ceilings, the best way to make top-down budgeting work in most countries is a properly designed system with indicative allocations to ministries and the limited possibility of additional funding from an unallocated portion of the aggregate ceiling. However, these indicative allocations need to be credible and accompanied by a range of measures to contain requests for additional funding.

Annexes

Annex 1: Top-Down Budgeting in a Medium-Term Framework — An Example

Suppose that, in the preparation of a country's 2026 budget, the following aggregate ceilings are applied: $100bn for 2026, $102bn for 2027 and $104bn for 2028. These ceilings will be set out in the budget circular issued by the Ministry of Finance (MOF) at the end of the strategic phase of the budget preparation process, which takes place during 2025. The unchangeable character of these ceilings means that, during the elaboration of the 2026 budget that follows, these ceilings will not be increased. The MOF will ensure that all spending decisions taken respect the ceilings not only in 2026, but also in the two outer years 2027 and 2028.

If the country concerned has a rolling medium-term budget, it will the following year prepare a 2027 budget framed in the three-year perspective 2027-2029. If it has a system where the outer year ceilings are "indicative," it will at that time revise the 2027 and 2028 ceilings (e.g. in the light of changed macroeconomic prospects), and add a ceiling for 2029. Suppose that the new ceilings are $101.8bn for 2027, $103.7b. for 2028 and $105bn for 2029. The 2027 budget will then be prepared on the basis of these. Once again, these ceilings will not change after the strategic phase of the 2027 budget preparation process.

By contrast, if the country has (like Sweden) a rolling framework with fixed outer-year ceilings, then when it comes to preparing the 2027 budget it will leave the ceilings for 2027 and 2028 untouched (at $102bn for 2027 and $104bn for 2028). But this makes no difference to the fact that these ceilings then remain unchanged during the preparation of the 2027 budget.

What this example illustrates is that the unchangeable nature of ceilings during the budget preparation process has nothing to do with the separate issue of whether outer-year ceilings in a medium-term framework are indicative or "fixed" (i.e., not revised when the year concerned arrives). Even in TDB systems where the outer-year ceilings are indicative, so that they are recalibrated once the year concerned arrives and budget preparation for that year starts, they then are unchangeable after the strategy phase of that year's budget preparation process.

Annex 2: Aggregate Ceilings and Expenditure Rules

Some of the literature treats expenditure ceilings as a type of expenditure rule[29]. This is, however, inconsistent with the widely held general concept of a fiscal rule. A fiscal rule is, in the standard Kopits-Symansky definition, a "permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance" (Kopits, 2001). "Permanent" is the key word here and means that a fiscal rule must be formulated in a general way that can be applied to any year. Fiscal objectives that are amounts that apply to specific years are therefore not fiscal rules in the Kopits-Symansky sense. A standing requirement that the structural budget must never exceed 1 percent is a fiscal rule. A decision that the budget deficit should not exceed 1 percent in 2027 is not. Nor is an objective of reducing debt by 5 percent of GDP over the next 4 years.

If an expenditure rule is understood to be a type of fiscal rule, an expenditure ceiling cannot qualify as an expenditure rule because it is an amount that limits expenditure in a specific year. By contrast, a standing requirement that aggregate government expenditure not exceed, say, 40 percent qualifies as an expenditure rule, as does a requirement that expenditure not grow faster than the rate of growth of GDP.

But is it possible to base ceilings on expenditure rules, rather than taking the approach used by the pioneer countries os starting with a demanding budget balance objective and then jointly determining the expenditure ceilings and revenue policy stance? In addressing this question, it is important to distinguish between an upper limit and a ceiling. One of the key characteristics of a ceiling, as noted in the main text, is that the budget may approve any amount of expenditure up to the level of the ceiling. This means that, if ceilings are properly specified, expenditure at the maximum level permitted by the ceiling would be compatible with any other government fiscal objectives and rules. Although an expenditure rule imposes an upper limit to expenditure, it is not necessarily the case that any level of expenditure up to that limit will be acceptable. It may be that spending at the limit is not possible because it would breach other fiscal objectives or rules, or would require a level of taxation that decision-makers are unwilling to countenance. Only if the upper limit imposed by an expenditure rule is consistent with other fiscal policy rules and objectives can the rule be used to set expenditure ceilings. If not, any ceilings would have to be set at levels below the upper limit specified by the expenditure rule.

When assessing the possibility of setting ceilings based on expenditure rules, it is useful to distinguish between two types of expenditure rules. The first are "net" expenditure rules that expressly link the upper limit on expenditure to revenue. The other type of expenditure rule imposes upper limits on expenditure that are unrelated to revenue.

A Net Expenditure Rule

The most well-known net expenditure rule is a rule that stipulates that expenditure may only grow at the rate of growth of potential GDP unless there is a change in the revenue policy

[29] For example, Ayuso-i-Casals (2012) and Cordes et al (2015). The latter paper includes ceilings which are set for three years or more in its definition of expenditure rules. It further confuses matters by using the term "ceilings" to refer to expenditure rules setting a maximum expenditure/GDP ratio or a maximum rate of growth of expenditure/GDP.

stance, in which case expenditure is permitted to increase or decrease by the amount of the change in structural revenue. This rule is the starting point of the “net expenditure path” approach that the European Union has adopted to specify expenditure limits for member countries (EGOV, 2024; Darvas, Welslau and Zettelmyer, 2024; Wyplosz, 2023).

This is a “net” expenditure rule in the sense that the limit it imposes is adjusted for augmentations or reductions in revenue arising from changes in the revenue policy stance (i.e. for Δr), making it neutral with respect to the size of the state.

This rule does not require that any decision on the revenue policy stance be made early in the budget preparation process. Deciding to raise taxes after having reviewed bottom-up budget requests from spending ministries would be entirely consistent with it. The rule does not, therefore, require the adoption of TDB.

In considering whether it would be possible to set expenditure ceilings on the basis of this rule, it is essential to recognize the implications of the key assumption behind the rule. The assumption is that, in the absence of any change in the revenue policy stance, structural revenue would tend to grow at the same rate as structural GDP – in other words, that r_b is constant. If this assumption is true,[30] then maintaining expenditure at the level permitted by this rule would — irrespective of whether the revenue policy stance changes or remains unchanged — result in the structural budget balance remaining constant as a percentage of GDP. The net expenditure rule is therefore approximately equivalent to a requirement that $e \leq r_b + \Delta r - b_0$, where e is expenditure/GDP and b_0 is the structural budget balance as a percentage of GDP at the time the rule is introduced.

If expenditure ceilings were to be set using this formula (i.e., $c = r_b + \Delta r - b_0$), the single significant difference with the standard approaches to setting ceilings (as outlined in this note) would be that the budget balance factor b_0 would represent the initial year value of the budget balance rather than the government’s target budget balance objective (b^*). Setting expenditure ceilings based on the net expenditure growth rule would therefore be essentially equivalent to setting them based on a budget balance objective.

It follows that, if it were possible to base expenditure ceilings on this expenditure rule, the framework used in this note to analyze TDB would not change.

However, deriving expenditure ceilings from such an expenditure growth rule would only work in limited circumstances. It would not work in any country where the budget deficit was too high in the initial year, because maintaining that deficit level into the future would generate unsustainable levels of debt. Only if the initial year budget balance was already at a sustainable level would the approach work. But, in this case, basing ceilings on the expenditure rule would be equivalent to basing them on a budget balance objective — I.e., the objective of maintaining the budget balance at the initial year level ($b^* = b_0$).

It is for this reason that the European Union’s approach to setting expenditure limits qualifies the growth rate rule by providing that, if a country’s debt and/or deficit exceed certain levels, expenditure limits must be set at levels below those required by the growth rule. (This applies,

[30] Which it generally is, approximately, in advanced economies with diverse revenue bases.

for example, if b_0 exceeds minus 1.5 percent of GDP.) Without going into the complex methodology used to make such downward adjustments, it may be said that they change little with respect to the implications of using the EU expenditure limits as the basis for setting aggregate ceilings within a TDB system.

An Expenditure Rule Unrelated to Revenue

An example of an expenditure rule that imposes an upper limit on expenditure that is unrelated to revenue is a limit on expenditure/GDP. Another example is the expenditure rule that applied in Brazil between 2016 and 2022, which specified that primary expenditure (i.e., expenditure excluding interest payments) must not grow at a rate faster than GDP — irrespective of the level of revenue.

Basing ceilings on such a rule would make it impossible to increase or reduce the level of aggregate expenditure either to accommodate major spending pressures or to achieve tax reduction objectives. It would freeze the size of the state in a way that would, under most circumstances, be unduly inflexible. This may make sense on a purely temporary basis to achieve fiscal consolidation under challenging circumstances, as in Brazil at that time. But it will not work in most countries, or anywhere over the long term.

It would also mean that, unlike the approach to ceiling-setting in the pioneer countries, the revenue policy stance would no longer be a policy choice. This is because it will only be feasible to use the rule as the basis for setting expenditure ceilings if the revenue policy stance is set to ensure fiscal sustainability. The Brazilian expenditure rule illustrates this point. It can be shown that, under normal circumstances, spending at the maximum level permitted by this rule will only be fiscally sustainable if revenue equals or exceeds a level that will keep the debt/GDP ratio constant. Mathematically, the requirement is:

$$r(\rho) \geq (i - g)/(1+g).d_0 + pex_0$$

where i is the nominal interest rate, g the nominal GDP growth rate, d_0 the initial debt ratio, and pex_0 the initial ratio of primary expenditure to GDP.[31]

If the level of primary expenditure at the time that this rule starts to be used as the basis for setting expenditure ceilings is too high relative to revenue, this approach will require a significant upward adjustment of revenues. If this is not politically acceptable, it will be necessary to set primary expenditure at a level lower than would be permitted by the rule, in which case the rule could not serve as the basis for setting ceilings.

[31] Of course, it would also work if any revenue overshoot so under shoots relative to this formula were compensated over time.

Annex 3: The Golden Rule and Top-Down Budgeting

One potential way of easing the fiscal strain of the current era would be the adoption of the golden rule of public finance (the GR). In the interests of intergenerational equity and tax smoothing, the GR permits the use of debt to finance capital expenditure (more precisely, to finance *net* capital expenditure). On the other hand, it requires that the operating expenses of government be funded entirely by revenue, with no recourse to debt.[32] The GR shifts the focus away from managing the overall budget balance (revenue minus total expenditure) to managing the current balance (more precisely, the operating balance). This points to the possibility of a GR version of TDB in which aggregate ceilings would cover only current expenditure.

Annex 4 provides further detail on the fiscal accounting for the GR.

The GR makes a significant difference if there is a step increase in capital expenditure. This is precisely the situation in which many governments find themselves today, when certain of the spending pressures they face are in areas that require substantial capital expenditure. Whereas a conventional budget balance rule requires most such investments to be entirely paid for upfront by the taxpayer, the GR allows the cost to be spread over time into the future.

The GR does not, however, justify unlimited debt. In isolation, the rule cannot guarantee fiscal sustainability, because it is possible to accumulate unsustainable levels of debt through excessive capital expenditure. For this reason, it needs to be accompanied by a debt limit. The combination of a requirement for a balanced operating budget and a debt limit is the way in which, for example, the UK government applied the GR from 1997 to the global financial crisis.

In a GR context, the difference between the debt limit and actual debt — what might be called the *borrowing room* — represents the maximum amount of additional debt that might be taken on to finance investment. If actual debt is above the debt limit, borrowing room is negative and the GR justification for borrowing to finance additional investment is inapplicable. This is, unfortunately, the situation in which many OECD countries find themselves today. In such countries, the GR is essentially irrelevant. Because they need to bring their debt levels down over time, it makes sense for them to continue to target the overall budget balance.

The GR is, on the other hand, potentially relevant for countries where debt is low or moderate and there is positive borrowing room. A significant minority of OECD countries are today in that position — including, unsurprisingly, a number of countries with successful TDB systems. For such countries, adopting the GR would mean no longer targeting the overall budget balance but focusing on the operating balance. This does not mean that they could cease to exercise discipline with respect to capital expenditure — it would remain important for them to carefully manage the way they use the borrowing room available to them.[33] But there would be no rules or targets governing annual capital expenditure, the amount of which might potentially vary significantly between years.

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[32] Just like a conventional budget balance rule, this should be qualified by cyclical adjustment and escape clauses which would allow the temporary use of debt — in this case to fund some current deficits — to deal with recessions and major crises.

[33] Something that they can do mainly through planning and budgetary mechanisms which allow them to appropriately ration the use of borrowing room between competing projects and over time.

What this means is that a GR version of TDB would not be appropriate for a country with excessive debt. For such countries, the need to control the overall budget balance means that a conventional TDB system with ceilings covering total expenditure — current and capital — would continue to make sense even if they subscribe philosophically to the logic of the GR.

A GR version of TDB would, however, be feasible for countries with positive borrowing room. Ceilings that cover only current expenditure would be used, and their fiscal anchor would be the GR objective for the current/operating balance.

Would expenditure ceilings that only cover current expenditure make sense? The answer is clearly "yes" because such ceilings would remain a valuable instrument to mitigate bottom-up spending pressures and exercise explicit control over the size of government.

The case for a GR-based version of TDB is strengthened by the problems that TDB countries have faced arising from the inclusion of capital expenditure in their aggregate expenditure ceilings – problems due to the variability of capital expenditure, the uncertainty of the timing of payments and the "indivisibility" of big projects (Ljungman, 2008). Most of these countries have, as a consequence, implemented workarounds that have had the effect of partially exempting capital expenditure from the ceilings.[34]

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[34] Sweden uses an "internal loans" mechanism to fund some capital expenditure. This is a mechanism which essentially replicates the effect of the application of the golden rule. Denmark excludes capital expenditure from the ceilings (Danish Government, 2013), although this does not have the effect of the golden rule capital expenditure is considered when determining a thing the ceiling for operating expenditures. Finland excluded a major investment program valued at EUR 4 billion from its ceilings for the 2024-27 because the timing of the spending was unclear (Ministry of Finance, 2024).

Annex 4: Accrual Fiscal Accounting and Top-Down Budgeting

The budget balance objectives that underpin expenditure ceilings may be expressed in cash or accrual accounting terms. If they are formulated in accrual terms, the expenditure ceilings should also be expressed in accrual terms. At least two of the countries with well-established TDB (Switzerland and Denmark) have accrual budgeting systems. For this reason, and because the proper formulation of the golden rule of public finance requires accrual accounting, it is useful to elaborate on the accrual fiscal accounting concerned.

Accrual Formulation of Ceilings Covering Current and Capital Expenditure

Switzerland applies expenditure ceilings that cover total expenditure (current plus capital expenditure) and that make use of an accrual concept of total expenditure that is not something that appears in a conventional accrual operating statement but is readily derived from it.

For these purposes, an accrual version of the concept of "current expenditure" is used. This is not the same as accrual operating expenses. It refers, rather, to the part of operating expenses that adds to debt.[35] Depreciation does not add to debt, so this concept of current expenditure equals operating expenses minus depreciation.[36] Adding together current expenditure defined in this manner and capital expenditure[37] gives a measure of total expenditure that measures flows that add to debt. (This contrasts with the accrual concept of expenses, which measures flows that reduce net worth.) This concept of total expenditure is necessary because a key function of the ceiling is to control debt, not net worth.

In Swiss fiscal accounting, the current budget balance (i.e., revenue minus current expenditure) also plays a role. It is referred to, in Swiss terminology, as "auto-financing." This is because the structurally balanced budget principle that guides Swiss fiscal policy requires that capital expenditure be totally financed by revenues — i.e., that there should be a current surplus equal to gross capital expenditure.

Accounting for the Golden Rule

The reason that the proper formulation of the golden rule of public finance requires accrual accounting is the role played by depreciation. As noted in Annex 3, the GR permits debt financing only of "net" capital expenditure. Net capital expenditure means gross investment minus depreciation. Permitting the use of debt only for net investment means requiring that each year an amount of debt equivalent to accounting depreciation is repaid. Although the principle of intergenerational equity justifies the use of debt to finance the creation of non-financial assets, it also requires that the debt concerned be progressively repaid over the lifetime of the asset by those benefiting from it. The required amortisation of the cost of the assets is captured (or rather approximated) by accounting depreciation.

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[35] "Debt" in this context refers to the broader accrual debt measure *net financial liabilities* (net financial worth with a minus sign) defined as liabilities minus financial assets.
[36] This simplifies for clarity of exposition.
[37] Defined in the broad sense of any reduction in financial assets, or assumption of liabilities, to acquire non-financial assets.

Note that this means that the GR only justifies increased debt if net capital expenditure is positive — i.e., if the government capital stock is growing.

In flow terms, the GR requires that all the operating expenses of government — including depreciation — are covered by revenue. This means that the accrual "operating balance" (revenue minus expenses) should be zero.

The GR is often described as a requirement for current budget balance. But this is not quite right. The current budget balance — revenue minus current expenditure — is equivalent to the operating balance plus depreciation. Given this, the GR balanced operating budget requirement translates into a requirement of a current surplus equal to depreciation.

Nevertheless, in a GR version of TDB, ceilings only need to cover current expenditure (i.e., expenses other than depreciation). This is because depreciation is inherited rather than controllable during budget preparation and cannot be constrained by expenditure ceilings. Like the expenditure items that are excluded in the calculation of conventional expenditure ceilings, depreciation needs to be taken into account when the current expenditure ceilings are calculated.

An issue that is frequently constantly in discussions of the GR is whether the rule's logic applies not only to investment in fixed assets but to investments more broadly defined, such as education and scientific research. This issue is beyond the scope of this note. It is, however, much less significant than often thought, because the GR justifies debt only for *net* investment and only makes a significant difference when gross spending on the category of "investment" concerned is quite variable.

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