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The hidden threat: The effects of off-budget expenditures on fiscal sustainability

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Abstract
Off-budget expenditures fiscal activities occurring outside the formal government budget pose serious challenges to fiscal transparency, macroeconomic stability, and long-term sustainability. These expenditures, which include quasi-fiscal activities, extra-budgetary funds, state-owned enterprise liabilities, and contingent guarantees, often escape legislative oversight and are excluded from official deficit and debt statistics. While off-budget mechanisms may offer short-term flexibility and facilitate politically sensitive expenditures, their persistent and opaque use distorts fiscal reporting, erodes public trust, and undermines sound fiscal governance.

This paper investigates the typologies, causes, and consequences of off-budget expenditures and analyzes their impact on fiscal sustainability across various governance contexts. Drawing from theoretical literature, institutional frameworks, and international case studies including Argentina, China, and Greece the study reveals that off-budget practices are a common feature across both developed and developing economies, often correlating with weak fiscal institutions and political pressures to circumvent fiscal rules.

The analysis shows that extensive off-budget activity contributes to hidden debt accumulation, reduced fiscal space, and greater vulnerability to economic shocks. The paper highlights the risks these practices pose to macroeconomic credibility, the delivery of public services, and sectoral planning, especially in climate finance and infrastructure development.

To mitigate these risks, the paper offers policy recommendations including expanding budget coverage, enhancing fiscal risk management, adopting performance-based budgeting, and improving public participation. The findings underscore the need for political commitment and institutional reform to integrate off-budget activities into transparent and accountable fiscal frameworks. Addressing off-budget expenditures is essential for ensuring resilient and sustainable public finance systems.

Keyword: Off-budget expenditures, fiscal sustainability, public financial management, budget transparency, hidden debt, quasi-fiscal activities, extra-budgetary funds, sovereign wealth funds, fiscal risk management, public-private partnerships

1. Introduction

Fiscal sustainability has become a defining concern for governments worldwide, especially in the face of rising public debt, persistent budget deficits, and growing demands on state resources. As policymakers seek to balance fiscal discipline with development needs, attention has increasingly turned toward the role of off-budget expenditures fiscal activities that fall outside the conventional budget framework but nonetheless impact government solvency, macroeconomic stability, and intergenerational equity.

Off-budget expenditures refer to spending activities, commitments, or liabilities that are not included in the official annual budget approved by the legislature. These may include extra-budgetary funds (EBFs), quasi-fiscal operations conducted by state-owned enterprises (SOEs), guarantees on public-private partnership (PPP) projects, the use of sovereign wealth funds (SWFs) outside budget oversight, and contingent liabilities that materialize unexpectedly. While these instruments are sometimes justified for their flexibility or political feasibility, their widespread and opaque use often undermines fiscal transparency, distorts financial reporting, and increases the risk of fiscal instability (Allen, Hemming, & Potter, 2013) [9]. Over the past two decades, a growing body of literature has identified off-budget expenditures as a major contributor to hidden debt accumulation and fiscal crises, particularly in emerging and resource-rich economies (Hemming & Petrie, 2000; Cangiano *et al.*, 2013; World Bank, 2021) [14, 23].

The issue is not limited to developing nations, however. Advanced economies have also used off-budget accounting to conceal deficits, avoid fiscal rules, or finance politically sensitive programs sometimes with grave consequences. The Greek debt crisis of the early 2010s, driven in part by concealed liabilities and statistical manipulation, is a stark reminder of the potential fallout from such practices (Reinhart & Rogoff, 2010) [22].

Beyond their macroeconomic implications, off-budget expenditures affect the quality of governance, democratic accountability, and the delivery of public services. By operating outside formal budgetary and legislative scrutiny, these mechanisms reduce transparency and limit citizen participation in fiscal decision-making. Abbasov (2025h) [1-8], in his analysis of participatory budgeting, argues that open and inclusive fiscal processes enhance public trust and resource efficiency goals that are undermined when significant portions of spending remain outside public view.

In many countries, off-budget expenditures are increasingly tied to climate adaptation, infrastructure investment, and social protection areas that require long-term fiscal planning and alignment with sustainable development goals. However, the fragmentation caused by extra-budgetary financing in these sectors often leads to inefficiencies, duplication of efforts, and misalignment with national strategies. In China, subnational governments utilize Local Government Financing Vehicles (LGFVs) to fund infrastructure projects outside formal budgets, contributing to a growing stock of hidden debt (World Bank, 2021) [23].

This article contributes to the existing literature by systematically examining the typologies, causes, and consequences of off-budget expenditures, with a specific focus on their implications for fiscal sustainability. It aims to answer three central research questions:

1. What are the primary forms and drivers of off-budget expenditures across different fiscal systems?
2. How do off-budget expenditures affect macroeconomic stability, public debt dynamics, and fiscal credibility?
3. What policy measures can governments adopt to improve transparency and mitigate the negative impacts of off-budget spending?

Methodologically, the study adopts a comparative and multidisciplinary approach, drawing from academic literature, institutional reports, and international case studies. Particular attention is paid to the experiences of Argentina, China, and Greece countries that have faced varying degrees of fiscal stress linked to off-budget practices. These case studies serve to contextualize the broader theoretical discussion and highlight institutional and political factors that influence fiscal behavior.

The structure of the paper is as follows:

- Section 2 reviews the conceptual framework and theoretical literature on fiscal sustainability and off-budget operations.
- Section 3 categorizes off-budget expenditures and explores global practices and typologies.
- Section 4 analyzes the macroeconomic and institutional impacts of these expenditures, with a focus on debt sustainability and public service delivery.
- Section 5 presents detailed case studies illustrating the real-world consequences of off-budget practices.
- Section 6 provides policy recommendations to improve fiscal reporting, risk management, and institutional oversight.
- Section 7 concludes with key findings, policy implications, and suggestions for future research.

As the global economy continues to grapple with post-pandemic recovery, climate challenges, and mounting public expectations, ensuring fiscal sustainability is not merely a technical exercise it is a prerequisite for long-term economic resilience, public trust, and inclusive development. Addressing the risks posed by off-budget expenditures is, therefore, not only a matter of sound accounting but a cornerstone of responsible governance.

2. Conceptual Framework and Literature Review

2.1 Defining Fiscal Sustainability

Fiscal sustainability refers to a government's ability to sustain current spending, tax policies, and other fiscal operations in the long run without threatening its solvency or defaulting on its obligations. The International Monetary Fund (IMF) defines fiscal sustainability as a condition in which the government can meet its current and future obligations without requiring a significant correction to its revenue or expenditure policies that could destabilize the economy (Escolano, 2010) [12]. From a broader policy standpoint, fiscal sustainability is not solely about budget balances or debt ratios, but about ensuring that fiscal policies contribute to long-term economic stability and growth.

Off-budget expenditures, which include liabilities and spending commitments not captured in official budget documents, pose serious risks to fiscal sustainability by creating hidden liabilities and eroding fiscal transparency. These expenditures may appear benign in the short term, but they often accumulate into substantial fiscal burdens that surface during economic downturns or financial crises.

2.2 Nature and Typology of off-budget expenditures

Off-budget expenditures can be broadly classified into several categories:

- **Extra-budgetary funds (EBFs):** These are accounts that operate outside the standard government budget and often lack adequate oversight or reporting. Examples include social security funds, special-purpose funds, and revolving funds.
- **Quasi-fiscal activities (QFAs):** These are activities undertaken by state-owned enterprises (SOEs) or central banks that have fiscal implications but are not recorded in the budget, such as directed lending at below-market interest rates or subsidized utility pricing.
- **Contingent liabilities:** These include government guarantees on loans, public-private partnerships (PPPs), and pension obligations, which become explicit liabilities only under certain conditions.
- **Sovereign wealth funds (SWFs)** and other resource-based revenue vehicles that bypass parliamentary scrutiny.

These off-budget mechanisms may be employed for various reasons, such as political expediency, bureaucratic inefficiencies, or the desire to circumvent fiscal rules. While they may serve as useful instruments for short-term financing or political negotiation, they ultimately erode fiscal transparency and credibility when used extensively.

2.3 Theoretical Underpinnings and Political Economy

The use of off-budget expenditures is often rooted in the principal-agent problem in public finance. Governments (agents), driven by short-term political objectives, may conceal the true fiscal position from voters (principals) by shifting liabilities off the books (Irwin, 2015) [18]. This form of fiscal illusion can help politicians avoid the political costs of raising taxes or cutting popular expenditures. However, it distorts intertemporal policy choices and imposes long-term costs on fiscal stability.

Baldacci and Kumar (2010) [10] argue that high public debt levels exacerbated by off-budget commitments can lead to increased sovereign bond yields, raising borrowing costs and triggering debt sustainability crises. These risks are particularly acute in developing and emerging economies, where institutional capacities for financial oversight are often weaker.

Abbasov (2025b) [1-8] explores these dynamics highlighting how hidden liabilities distort not only debt statistics but also the effectiveness of fiscal stimulus and social programs. The presence of off-budget expenditures also undermines the effectiveness of performance-based budgeting, as shown in Abbasov's empirical work (2025d) [1-8], where the disconnect between allocated resources and actual spending commitments weakens budget accountability and program evaluation.

2.4 Literature on Transparency and Accountability

The fiscal transparency literature emphasizes that comprehensive reporting and coverage of all government operations including off-budget items are essential for sound fiscal management. Hemming and Petrie (2000) [14] developed a framework for assessing fiscal vulnerability, underscoring the role of extra-budgetary mechanisms in increasing fiscal risks. Cangiano, Curristine, and Lazare (2013) [11] also argue that fragmented fiscal systems encourage inefficiencies and reduce the credibility of fiscal rules. Performance gaps in budget coverage and comprehensiveness are well-documented in international assessments such as PEFA and the Open Budget Index. Abbasov (2025c) [1-8] provides further evidence of how fragmented budget systems, especially in welfare-oriented economies, challenge the sustainability of fiscal policies. He shows that when governments resort to off-budget arrangements to fund social programs, they often sacrifice long-term solvency for short-term political gains.

This aligns with international experiences. In the U.S., for example, federal trust funds operate largely off-budget and are not included in unified budget accounting, thus complicating deficit calculations. In China, Local Government Financing Vehicles (LGFVs) represent a major form of off-budget borrowing, contributing to mounting subnational debt that is often unaccounted for in official statistics.

2.5 Implications for social and sectorial spending

The literature also highlights the adverse impacts of off-budget expenditures on public service delivery and macroeconomic policy coordination. Ramil Abbasov (2025g) [1-8] documents how budgetary fragmentation caused by off-budget obligations leads to funding shortfalls in health, education, and social welfare sectors. These pressures intensify during economic downturns when hidden liabilities surface, crowding out essential public spending.

Moreover, Abbasov (2025a) [1-8] shows how differing institutional frameworks affect the prevalence and impact of off-budget practices. In federal systems, subnational units may accumulate off-budget liabilities independently, exacerbating fiscal fragmentation and complicating national policy coordination.

2.6 Gaps in the Literature and Research Opportunities

While existing literature extensively documents the types and risks of off-budget expenditures, there are still several underexplored areas:

- The long-term fiscal implications of contingent liabilities arising from PPPs in developing countries.
- The effectiveness of fiscal councils in curbing off-budget practices.
- The interaction between participatory budgeting and fiscal transparency in reducing off-budget incentives (Abbasov, 2025h) [1-8].

There is also a need for more empirical research on how off-budget expenditures affect fiscal multipliers, macroeconomic volatility, and income distribution. With growing global pressures from demographic changes to climate adaptation understanding the structural drivers of off-budget behavior has never been more critical.

3. Off-Budget Expenditures: Typologies and Global Practices

Off-budget expenditures are fiscal activities that are not included in the annual budgetary appropriations passed by the legislature, yet they still create obligations or involve the use of public resources. These expenditures undermine budget comprehensiveness and often reflect a parallel fiscal system that operates beyond the scrutiny of traditional oversight institutions. In this section, we classify and analyze the major types of off-budget expenditures and provide global case studies to illustrate how such practices impact fiscal transparency and sustainability.

3.1 Typologies of Off-Budget Expenditures

a) Extra-Budgetary Funds (EBFs)

Extra-budgetary funds refer to institutions or programs that receive revenues and incur expenditures outside the central government’s budget process. These funds are often set up for specific purposes, such as social insurance, infrastructure investment, or stabilization. While EBFs can enhance earmarking and protect strategic expenditures, they frequently escape the same level of scrutiny applied to core budget items, making them a vehicle for off-budget fiscal activity (Allen, Hemming, & Potter, 2013) [9].

For instance, many countries have social security funds that operate off-budget. In the United States, the Social Security Trust Fund is technically off-budget and does not count toward the unified budget deficit, creating ambiguity around the true fiscal stance. Similarly, in countries like Russia and Kazakhstan, national oil funds accumulate petroleum revenues but operate with limited parliamentary oversight.

b) Quasi-Fiscal Activities (QFAs)

Quasi-fiscal activities are non-budgetary operations performed by public institutions often state-owned enterprises (SOEs) or central banks that have a fiscal effect. These include below-cost utility pricing, directed credit, loan guarantees, or the assumption of private liabilities. Because QFAs are not recorded in the fiscal accounts, they obscure the government's true financial position and complicate macroeconomic management (Cangiano, Curristine, & Lazare, 2013) [11].

Abbasov (2025d) [1-8] notes that QFAs distort the alignment between resource allocation and performance measurement, which undermines strategic budget management. This disconnect weakens the credibility of fiscal policy, especially in countries where SOEs are heavily involved in public service delivery or infrastructure.

c) Public-Private Partnerships and Government Guarantees

Governments often enter into public-private partnerships (PPPs) to mobilize private investment for public infrastructure without reflecting the full fiscal cost in the budget. Although PPPs can be efficient financing mechanisms, the associated contingent liabilities (such as minimum revenue guarantees) are typically off-budget unless they are realized.

Similarly, government guarantees on loans, pensions, or financial instruments are not immediately recorded as expenditures, but they pose serious fiscal risks. In periods of economic distress, these guarantees may be called, leading to unexpected fiscal burdens. The IMF (2018) and World Bank (2021) [23] have highlighted the need for more comprehensive disclosure of contingent liabilities, which are often underestimated in national accounts.

d) Sovereign Wealth Funds and Stabilization Funds

Natural resource-exporting countries often establish sovereign wealth funds (SWFs) or stabilization funds to manage volatile revenues and smooth expenditure over time. However, these funds are frequently structured outside the main budget framework and may be used to finance politically sensitive or strategic projects off-budget. This diminishes transparency and can mask the true fiscal deficit, especially when funds are diverted to non-commercial or patronage-based projects.

e) Local Government Financing Vehicles (LGFVs)

One of the most pronounced examples of off-budget borrowing is found in China, where Local Government Financing Vehicles (LGFVs) were created to circumvent legal restrictions on direct borrowing by local authorities. These entities have borrowed extensively through special purpose vehicles to finance infrastructure projects, leading to a rapid buildup of hidden debt (World Bank, 2021) [23].

3.2 Global Practices and Country Examples

China: Subnational Hidden Debt

China's experience offers a textbook example of how off-budget expenditures can accumulate into systemic fiscal risks. While local governments are legally barred from borrowing, they have increasingly relied on LGFVs to bypass these constraints. As of 2022, estimates of China's local government hidden debt surpassed 40 trillion YUAN ($5.9 trillion), much of it off-budget (World Bank, 2021) [23].

This hidden debt buildup has serious implications for macroeconomic stability, especially amid slowing growth. The IMF and Moody's have warned of the rising risks associated with implicit guarantees and fiscal backstopping by the central government.

Greece: Statistical Manipulation and Fiscal Crisis

Greece's 2010 debt crisis partly stemmed from the creative use of off-budget mechanisms, including derivatives and swaps, to mask its true fiscal position. These accounting gimmicks allowed the government to report a lower deficit than was actually incurred. When the true scale of the debt became apparent, investor confidence collapsed, leading to a full-blown sovereign crisis and IMF/EU bailout.

This case illustrates how off-budget practices not only distort fiscal reporting but can precipitate a loss of market credibility and a sharp rise in borrowing costs (Reinhart & Rogoff, 2010) [22].

Argentina: Hidden Liabilities and Recurring Crises

Argentina has historically employed off-budget practices to finance public expenditures, including through central bank financing and public pension system interventions. These practices have contributed to chronic inflation, periodic defaults, and a general lack of fiscal credibility. IMF Country Reports detail how off-budget obligations and subsidies have consistently undermined fiscal discipline.

3.3 Sectoral Examples: Climate Finance and Military Spending

Off-budget expenditures also tend to be significant in climate and defense sectors. In many countries, climate adaptation projects are funded by a mix of donor assistance, sovereign wealth funds, and extra-budgetary mechanisms. These practices, while useful in mobilizing resources, risk fragmenting fiscal reporting and diminishing oversight (Abbasov, 2025b) [1-8].

Abbasov (2025f) [1-8] explores how countries often shield defense-related expenditures from public scrutiny by placing them off-budget or under classified spending regimes. This practice weakens democratic accountability and can result in resource misallocation.

3.4 The Role of Institutions and Legal Frameworks

The prevalence of off-budget expenditures is often inversely related to the strength of a country's public financial management (PFM) system. Countries with strong institutions, independent audit bodies, and transparent fiscal frameworks are better equipped to manage and disclose off-budget commitments.

Conversely, countries with fragmented PFM systems are more likely to use off-budget practices as fiscal escape routes. The OECD (2015) notes that while all countries use some form of extra-budgetary financing, only those with robust legal frameworks can ensure that these mechanisms do not undermine fiscal control.

3.5 Summary and Implications

Globally, off-budget expenditures take many forms and serve multiple purposes from infrastructure development and climate adaptation to social security and national defense. However, the misuse or excessive reliance on such mechanisms carries significant fiscal risks. The proliferation of these practices, especially in contexts lacking robust oversight, can lead to debt accumulation, undermine fiscal credibility, and trigger financial crises.

As such, it is imperative for countries to strengthen the comprehensiveness of their budget processes, integrate off-budget operations into fiscal reporting, and develop legal and institutional safeguards to manage fiscal risks transparently.

4. Fiscal Sustainability and the impact of off-budget practices

Off-budget practices are often introduced as temporary or politically expedient measures, but their long-term consequences can significantly undermine fiscal sustainability. Fiscal sustainability, in this context, refers to a government's ability to maintain its current levels of public spending and debt without resorting to excessive borrowing, inflationary financing, or abrupt adjustments that destabilize the economy. When off-budget expenditures obscure the true fiscal position of governments, they erode transparency, distort decision-making, and lead to unsustainable fiscal paths. This section explores the macroeconomic, institutional, and sectorial impacts of off-budget practices on fiscal sustainability.

4.1 Macroeconomic Consequences: Debt Accumulation and Interest Rate Pressures

One of the most direct and measurable impacts of off-budget expenditures is the accumulation of public debt that is not captured in traditional deficit metrics. These hidden liabilities stemming from extra-budgetary funds, contingent guarantees, or state-owned enterprises' obligations often remain unreported until they crystalize during periods of fiscal stress. The International Monetary Fund (IMF) has repeatedly warned that failing to account for such liabilities leads to underestimation of public debt and an overstatement of fiscal soundness (Escolano, 2010) [12].

For example, in countries such as China, the proliferation of Local Government Financing Vehicles (LGFVs) has resulted in trillions of YUAN in hidden debt. These entities operate outside the formal budget and have significantly raised concerns about systemic risk in the event of a fiscal crisis. According to World Bank (2021) [23], these off-budget debts are not only large in volume but also backed by implicit guarantees from central or local governments, further endangering fiscal stability.

As the debt burden grows both on and off the books governments may face rising interest rates and tighter credit conditions. Baldacci and Kumar (2010) [10] empirically show that fiscal deficits and high debt levels, particularly those that are opaque or hidden, are strongly correlated with higher sovereign bond yields. This correlation is particularly dangerous in emerging economies where access to international capital markets is contingent on perceived fiscal discipline.

4.2 Impact on Fiscal Credibility and Policy Effectiveness

Off-budget expenditures can severely erode the credibility of fiscal policy. When fiscal data does not accurately reflect the government's financial position, it becomes difficult for investors, multilateral institutions, and credit rating agencies to make informed decisions. The loss of credibility can result in a downgrade of credit ratings, capital flight, and pressure on exchange rates.

Countries that frequently resort to off-budget practices often find it difficult to implement effective countercyclical policies during economic downturns. The reason is twofold: first, hidden liabilities narrow the available fiscal space; second, opaque fiscal reporting leads to a lack of confidence in stimulus measures. In such cases, monetary policy also becomes less effective due to coordination issues and lack of fiscal clarity.

Abbasov (2025b) [1-8] emphasizes the need for accurate fiscal data in implementing development and redistribution programs. He argues that fiscal credibility is not only a macroeconomic requirement but also a foundation for social policy. Where governments mask liabilities and offload expenditures from the budget, they undermine the long-term predictability required for sound social investment.

4.3 Budget Transparency and Oversight Mechanisms

The presence of substantial off-budget expenditures often reflects weak institutions and a lack of commitment to fiscal transparency. The OECD (2012) and IMF (2014) both emphasize that a comprehensive and unified budget is essential for sound fiscal governance. Off-budget practices undermine this principle, making it difficult for parliaments and supreme audit institutions to exercise meaningful oversight.

This lack of transparency is further exacerbated when off-budget mechanisms are used for politically sensitive expenditures such as military spending or infrastructure investments in politically strategic regions. As Abbasov (2025f) [1-8] notes many governments deliberately keep defense expenditures off the main budget to avoid public scrutiny, leading to fiscal distortions and a reduction in accountability.

4.4 Effects on Social Services and Sectoral Spending

Off-budget practices also have critical implications for the sustainability and equity of public services. Hidden liabilities and spending commitments often crowd out necessary social expenditures, such as health care, education, and infrastructure. When these sectors are deprioritized due to unanticipated debt servicing costs or contingent liability realizations, the long-term development prospects of the country suffer.

Ramil Abbasov (2025g) [1-8] documents the negative consequences of budget compression caused by rising off-budget obligations. His findings indicate that education and health sectors are often the first to face cutbacks when fiscal corrections are needed, reinforcing social inequality and undermining human capital development.

Additionally, the use of off-budget mechanisms may bypass performance-based or participatory budgeting practices. Abbasov (2025h) [1-8] argues that involving citizens in budget planning enhances transparency and allocative efficiency. However, when large portions of public funds are disbursed through opaque channels, the benefits of participatory governance are largely negated.

4.5 Risks from Contingent Liabilities and Public-Private Partnerships (PPPs)

Another significant pathway through which off-budget expenditures affect fiscal sustainability is via contingent liabilities. These are obligations that only become liabilities if certain events occur such as a PPP failing to generate expected revenues or a state-owned enterprise defaulting on its debt. While such liabilities are not part of the annual budget, they still represent potential fiscal burdens.

For instance, many governments provide minimum revenue guarantees to private partners in infrastructure projects. These guarantees do not count toward the budget deficit unless activated but represent a very real fiscal risk. The IMF (2018) has noted that the underreporting of such guarantees is a widespread problem, and that their eventual realization can severely disrupt fiscal planning.

4.6 Empirical Evidence and Country Comparisons

Empirical analysis supports the assertion that countries with a high incidence of off-budget practices face greater fiscal volatility and debt sustainability challenges. Eurostat (2022) data from EU countries shows that those with comprehensive budget coverage and effective oversight such as Sweden or Germany exhibit better fiscal resilience during shocks. In contrast, countries that relied heavily on off-budget operations, like Greece or Portugal before the 2010s, experienced more severe fiscal crises.

Abbasov (2025a) [1-8] demonstrates that institutional architecture plays a vital role in mitigating the negative impacts of off-budget expenditures. His study shows that countries with decentralized governance and weak fiscal coordination mechanisms are more prone to accumulate hidden liabilities at the subnational level.

4.7 Climate Change and Sustainability Linkages

Off-budget expenditures in the climate change arena are also significant. Governments increasingly finance adaptation and mitigation projects through donor-funded programs or sovereign wealth funds that lie outside the budget framework. While this may enhance flexibility and attract international funds, it creates fragmentation in fiscal reporting and planning.

Abbasov (2025e) [1-8] underscores the need to integrate climate finance into the budget system to ensure long-term sustainability and coherence with development goals. Fragmented financing can hinder the strategic allocation of resources and complicate national planning for urban resilience.

4.8 Summary and Implications

The proliferation of off-budget expenditures poses a serious threat to fiscal sustainability across various dimensions macroeconomic, institutional, and sectoral. They inflate public debt, obscure fiscal performance, weaken oversight, and disrupt the delivery of essential public services. While such mechanisms may be justified in certain cases (e.g., emergency response, stabilization funds), their systematic use undermines sound fiscal governance.

To preserve fiscal sustainability, countries must commit to comprehensive and transparent fiscal reporting. This requires not only stronger public financial management systems but also political will to curb off-budget practices and prioritize long-term fiscal health over short-term expediency.

5. Case Studies

The theoretical and empirical analysis of off-budget expenditures gains richness and context when examined through country-specific experiences. This section presents four case studies Argentina, China, and Greece to illustrate how various forms of off-budget spending have been utilized, and the consequences such practices have had on fiscal sustainability, economic credibility, and social outcomes. The selected countries vary in terms of governance structures, fiscal institutions, and economic development, allowing for a diverse exploration of off-budget practices.

5.1 Argentina: Hidden Liabilities and Recurring Crises

Argentina presents one of the most illustrative cases of how recurrent off-budget practices can severely undermine fiscal discipline and credibility. Over the past few decades, Argentina has repeatedly engaged in quasi-fiscal operations, direct monetary financing by the Central Bank, and the off-budget use of pension funds to finance deficits. These practices, often driven by short-term political expediency, have created cycles of inflation, capital flight, and sovereign default.

A prominent example is the nationalization of private pension funds in 2008. While the move temporarily bolstered public revenues, it also shifted large future liabilities to the public balance sheet. Similarly, subsidies to energy and transport sectors were often carried out through off-budget channels, primarily by state-owned enterprises that accumulated massive deficits not reflected in the formal budget.

These hidden obligations contributed significantly to Argentina's sovereign debt crises in 2001 and again in the late 2010s. The IMF's post-crisis reports highlight that the lack of transparency in fiscal operations was a major barrier to sustainable macroeconomic management.

The fiscal opacity also limited the government's ability to engage effectively with international markets and institutions. Investor confidence deteriorated, and the country was forced to accept multiple IMF support packages with harsh conditionality's. Argentina's experience underscores the dangers of systemic off-budget operations in an environment of weak fiscal controls and populist fiscal policies.

5.2 China: Local government financing and subnational debt

China's unique fiscal system has given rise to extensive off-budget activity, particularly through the use of Local Government Financing Vehicles (LGFVs). Due to legal constraints on direct borrowing, subnational governments in China have relied heavily on LGFVs to finance urban infrastructure, public housing, and transportation networks.

LGFVs operate as special-purpose vehicles, often with implicit guarantees from local governments. They borrow from state-owned banks and issue bonds through local platforms. However, because their debt is technically not part of the official local government budget, it is not included in national debt statistics.

The scale of this off-budget debt is staggering. As of 2022, China's LGFV debt was estimated at over $5 trillion, representing more than a third of China’s GDP. This debt has created growing concerns among international observers, including the IMF and World Bank, about systemic risk and fiscal transparency.

While LGFVs have helped fuel rapid infrastructure development and urbanization, they have also created repayment pressures and reduced fiscal space for other expenditures. Recent attempts to restructure or consolidate this debt have included converting LGFV liabilities into municipal bonds, but challenges persist.

China’s case demonstrates that even in a strong centralized governance system, fiscal fragmentation through off-budget practices can introduce hidden vulnerabilities, especially when long-term obligations are mismatched with revenue streams.

5.3 Greece: Fiscal Deception and the Eurozone Crisis

Greece offers a stark example of the dangers posed by statistical manipulation and the use of off-budget accounting to meet external fiscal benchmarks. In the early 2000s, Greece engaged in several off-budget practices, including currency swaps and debt securitization deals with international banks (notably Goldman Sachs), to understate its budget deficits and public debt ratios critical metrics for meeting Eurozone entry requirements.

These instruments were not reported in official deficit figures and created the illusion of fiscal health. When the true scale of public debt was revealed during the global financial crisis of 2008-2009, investor confidence evaporated. The Greek government lost access to international markets, and the country had to rely on successive bailout packages from the IMF, the European Central Bank (ECB), and the European Commission (EC).

The consequences of this fiscal opacity were severe: Greece underwent a deep recession, unemployment soared above 25%, and harsh austerity measures led to widespread social unrest. The country’s GDP contracted by nearly 25% over a five-year period, and its public debt peaked at over 180% of GDP. The Eurostat investigation concluded that Greece’s use of off-budget arrangements had materially misrepresented its fiscal position, violating both EU statistical reporting requirements and international fiscal transparency standards. This episode led to major reforms in European fiscal governance, including the establishment of stronger fiscal councils and tighter deficit surveillance.

Greece’s case illustrates how off-budget practices not only distort fiscal data but can also jeopardize supranational integration, erode political trust, and catalyze long-term economic decline.

5.4 Lessons from Comparative Experience

Across all four case studies, a number of common themes emerge:

- **Fiscal opacity breeds instability**: Whether through statistical manipulation (Greece), monetary financing (Argentina), or subnational borrowing (China), off-budget practices that obscure the true fiscal position eventually undermine trust and stability.
- **Off-budget expenditures are politically convenient but economically risky:** Governments often turn to off-budget practices to bypass fiscal rules, delay unpopular reforms, or finance flagship projects without immediate cost implications.
- **Long-term sustainability requires integration:** Bringing off-budget expenditures into the formal budget process and subjecting them to regular oversight is key to preserving fiscal health and aligning policy priorities.

6. Policy Recommendations

Addressing the challenges posed by off-budget expenditures requires a multifaceted approach that strengthens fiscal institutions, enhances transparency, and reinforces accountability mechanisms. The goal is not necessarily to eliminate all forms of off-budget activity, as certain extra-budgetary mechanisms can serve useful policy functions such as stabilization funds, climate adaptation financing, or long-term infrastructure investments. However, these activities must be brought within a unified fiscal framework to ensure consistency with national priorities, minimize fiscal risks, and maintain sustainability.

This section outlines key policy recommendations across five strategic areas: institutional reform, budget integration, fiscal risk management, transparency enhancement, and participatory governance.

6.1 Institutionalizing Comprehensive Budget Coverage

One of the fundamental reforms needed is the expansion of the institutional scope of the budget to encompass all fiscal operations whether they occur within the central government, public enterprises, or extra-budgetary funds. Comprehensive budget coverage ensures that fiscal policy decisions are based on a full understanding of government financial activities.

To achieve this:

- Governments should consolidate extra-budgetary funds (EBFs) into the main budget, or at a minimum, require full disclosure and audit of their operations.
- State-owned enterprises (SOEs) and public-private partnerships (PPPs) should be included in fiscal statistics when they perform non-commercial activities or receive government guarantees.

As noted by the OECD (2015) and IMF (2020), the principle of “comprehensiveness” is foundational to sound fiscal policy. Without it, fiscal targets become meaningless, and fiscal policy becomes unmoored from economic reality.

6.2 Enhancing Fiscal Risk Management

Off-budget expenditures are often associated with hidden or contingent liabilities, such as guarantees, future payment obligations under PPP contracts, or SOE borrowing. These risks must be explicitly monitored, disclosed, and mitigated through well-designed frameworks.

Policy actions should include:

- Establishing fiscal risk units within Ministries of

Finance to track and model the impact of contingent liabilities on debt sustainability.
- Developing early warning systems for fiscal stress related to off-budget activities.
- Publishing comprehensive fiscal risk statements as part of annual budget documentation, in line with IMF and PEFA standards.

The IMF (2018) emphasizes that transparent disclosure of fiscal risks especially related to PPPs and guarantees—can improve investor confidence and reduce the likelihood of costly surprises.
Abbasov (2025a) [1-8] notes that the failure to monitor and report these risks at subnational levels has led to fiscal fragmentation and missed opportunities for coordinated responses to macroeconomic shocks.

6.3 Integrating Climate Finance and Sectoral Programs into the Budget
A growing share of off-budget activities are related to **climate adaptation**, donor-funded projects, or sector-specific development initiatives. While these sources of funding can support national priorities, they must be aligned with national budgetary frameworks to avoid fragmentation.
These steps would allow governments to coordinate funding, avoid duplication, and ensure that long-term sectoral goals (such as in health, education, or infrastructure) are not derailed by fiscal fragmentation.

6.4 Improving budget transparency and legislative oversight
Transparency is a critical condition for public trust in fiscal institutions. Citizens, investors, and legislatures must have access to accurate and comprehensive information about government finances including off-budget operations.
Key policy actions include:
- Adopting international transparency standards, such as the IMF's Fiscal Transparency Code or the Open Budget Index criteria.
- Requiring parliamentary approval for all forms of public borrowing, including guarantees and SOE debts.
- Strengthening the capacity and independence of supreme audit institutions to audit off-budget funds, SOEs, and PPP contracts.

As Abbasov (2025h) [1-8] highlights public involvement in fiscal decisions through mechanisms such as participatory budgeting can enhance accountability and reduce incentives for opaque spending practices.
Moreover, improving budget classification systems to include functional and programmatic dimensions allows for a clearer understanding of how resources are allocated, including in off-budget activities. This improves policy alignment and ensures value for money in public service delivery.

6.5 Establishing fiscal rules and independent oversight bodies
Fiscal rules when well-designed and supported by independent oversight can constrain excessive off-budget activity and promote sustainable public finances. These rules should be accompanied by escape clauses that allow flexibility during economic shocks but prevent abuse.

Best practices include:
- Implementing debt ceilings or structural balance rules that account for off-budget items and contingent liabilities.
- Creating independent fiscal councils to monitor compliance with rules and provide objective analysis of fiscal policies.
- Regularly reviewing fiscal rules to ensure adaptability and effectiveness.

In countries with weak fiscal rule enforcement, the temptation to shift expenditures off-budget is particularly high. Independent institutions can serve as important watchdogs to reduce this tendency and promote fiscal discipline.

6.6 Political Commitment and Cultural Change
Ultimately, the most effective fiscal reforms require more than technical solutions they demand political will and cultural change within the bureaucracy. Off-budget practices are often the product of short-term political incentives, pressure to meet rigid fiscal targets, or bureaucratic fragmentation.
Creating a culture of transparency and responsibility requires:
- Political leaders committing to medium-term fiscal strategies that prioritize sustainability over immediate popularity.
- Civil servants being incentivized to adopt transparent practices and discouraged from circumventing budget procedures.
- Public campaigns and civil society engagement to raise awareness of the importance of fiscal accountability.

6.7 Summary
To mitigate the adverse impacts of off-budget expenditures on fiscal sustainability, governments must undertake a comprehensive reform agenda. This includes institutionalizing budget comprehensiveness, strengthening risk management, enhancing transparency, and engaging citizens in budgetary processes.

7. Conclusion
Off-budget expenditures, though often adopted for pragmatic or political reasons, represent one of the most persistent threats to fiscal sustainability in both developed and developing economies. As this paper has demonstrated, the scope and nature of these expenditures vary widely from quasi-fiscal activities and sovereign wealth fund disbursements to contingent liabilities from public-private partnerships and off-the-books borrowing by subnational entities. Despite these differences, a common thread unites them: they obscure the true fiscal position of governments, reduce budget transparency, and expose economies to significant and often unanticipated fiscal risks.
Drawing on a combination of theoretical insights, empirical data, and case studies, this article has shown that the proliferation of off-budget expenditures undermines core principles of sound public financial management. Hidden liabilities accumulate silently, surfacing during economic

shocks and placing sudden and severe strain on public resources. Such practices weaken fiscal credibility, increase borrowing costs, and crowd out critical social and development spending ultimately hampering both macroeconomic stability and social equity.

The comparative country cases of Argentina, China, and Greece provide tangible illustrations of how off-budget practices if unchecked can contribute to fiscal crises or long-term structural imbalances. These cases also reinforce the importance of robust institutions, legal frameworks, and public oversight in mitigating the adverse impacts of extra-budgetary fiscal activity. Countries with more transparent and integrated fiscal systems have been better able to manage associated risks, whereas those relying on opaque practices have faced recurrent crises, debt overhangs, and loss of investor confidence.

The policy recommendations offered in this article are grounded in international best practices and supported by scholarly work, including Abbasov (2025) [1-8] and institutional sources such as the IMF, OECD, and World Bank. They call for greater budget comprehensiveness, stronger fiscal risk management, enhanced transparency, and the integration of sectoral programs especially in areas like climate finance and social spending into national budgets. Political will, citizen engagement, and institutional reform are indispensable for transforming fiscal culture and promoting accountability.

Looking ahead, future research should further examine the fiscal multiplier effects of off-budget expenditures, explore the interaction between fiscal decentralization and extra-budgetary liabilities, and assess the role of technology and digital tools in improving fiscal transparency. As governments face increasing demands for infrastructure, climate resilience, and social services, ensuring that all fiscal activities are visible, planned, and sustainable will be critical for safeguarding public trust and long-term economic resilience.

8. References

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