

The Return to Fiscal Rules

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SDN/2022/002

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STAFF DISCUSSION NOTE



FISCAL AFFAIRS

The Return to Fiscal Rules

FIBE CONFERENCE - FUTURE OF FISCAL GOVERNANCE FORUM

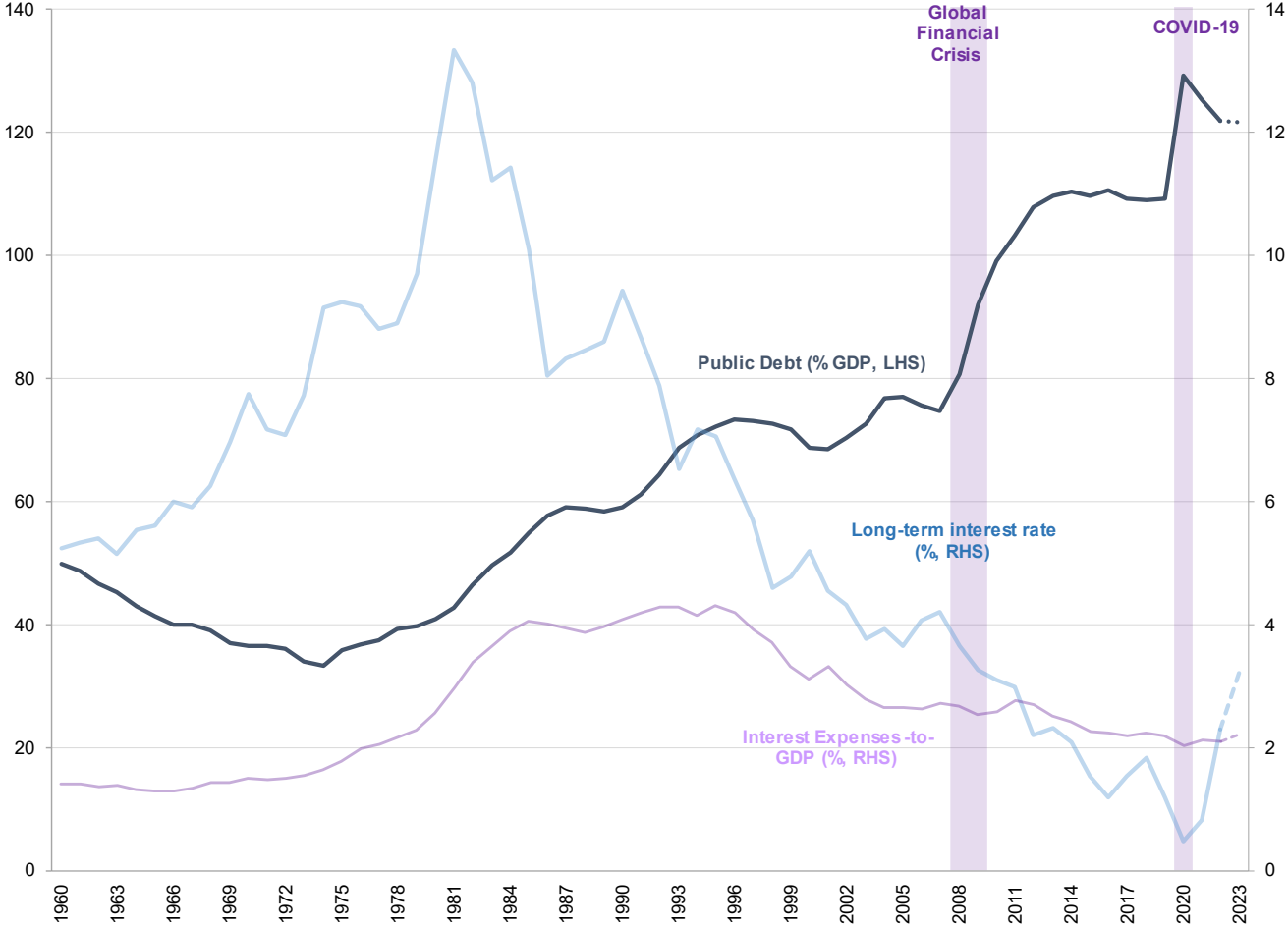
FEBRUARY 24, 2023

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Director
Fiscal Affairs Department

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Public Debt & Interest Rates in Advanced Economies

Historical Public Debt (in percent of GDP) & Long-Term Interest Rates (in percent, 1960-2023)

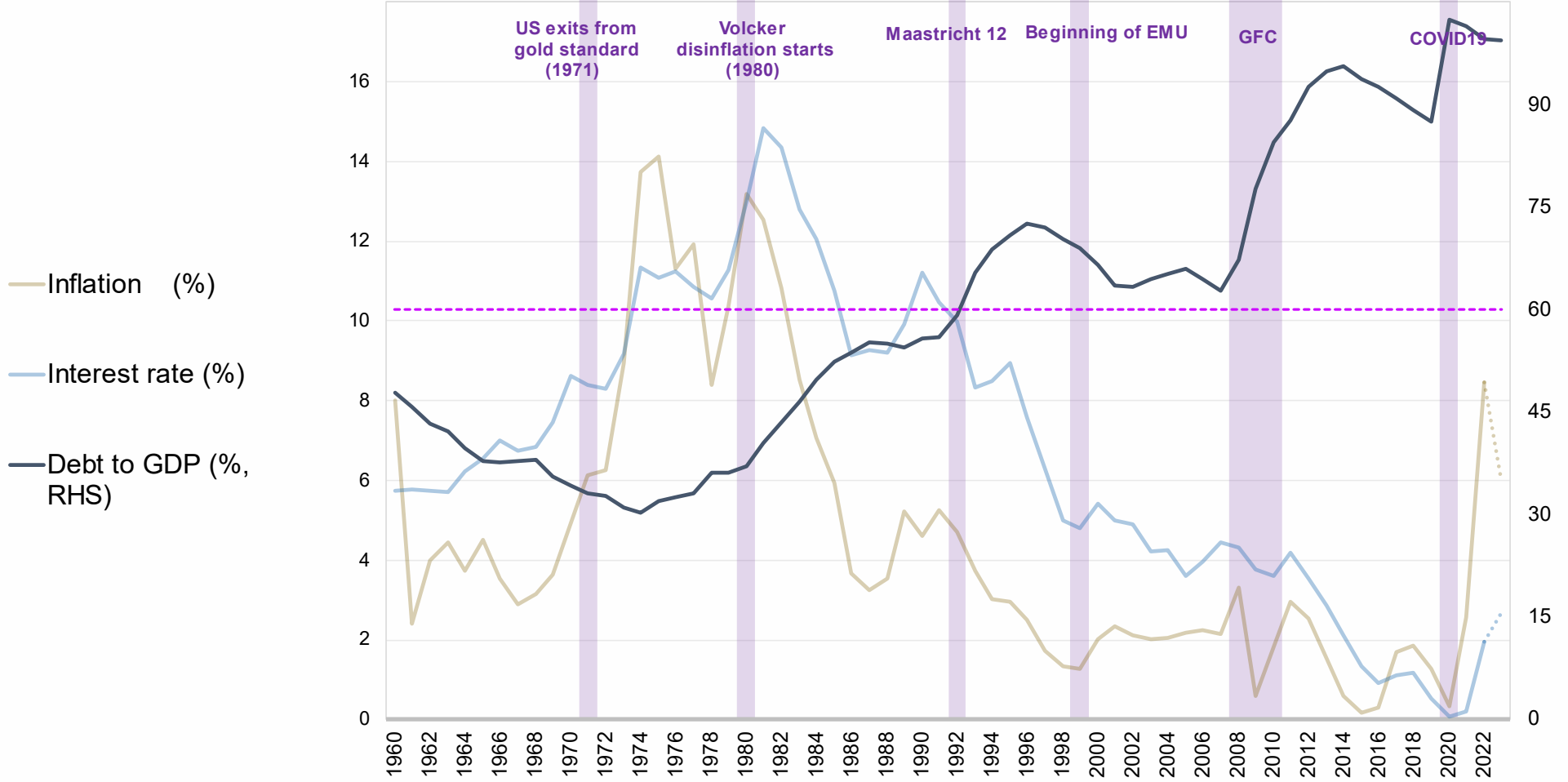


Sources: IMF, Historical Public Debt Database; Mauro et. al 'A Modern History of Fiscal Prudence and Profligacy'; IMF World Economic Outlook Database (January 2023); Maddison Database Project; Global Financial Database; Jorda, Schularick & Taylor 'Macroeconomic Database'; Thomson Reuters Datastream & IMF staff calculations.

Note: Data spans across the period 1960-2023. The data are in annual frequency. 2022 and 2023 values are estimations and forecasts from the IMF World Economic Outlook (WEO), respectively. The Advanced Economies aggregate is computed using a constant sample of 25 Advanced economies where public debt and long-term interest rates data are available through data compilation, linear interpolations for missing data between years, or back extrapolations using the aggregate debt trends in countries for whom data are available.

Debt, Inflation, and Interest Rates, 1960 - 2023

Maastricht12 (1960-2023)



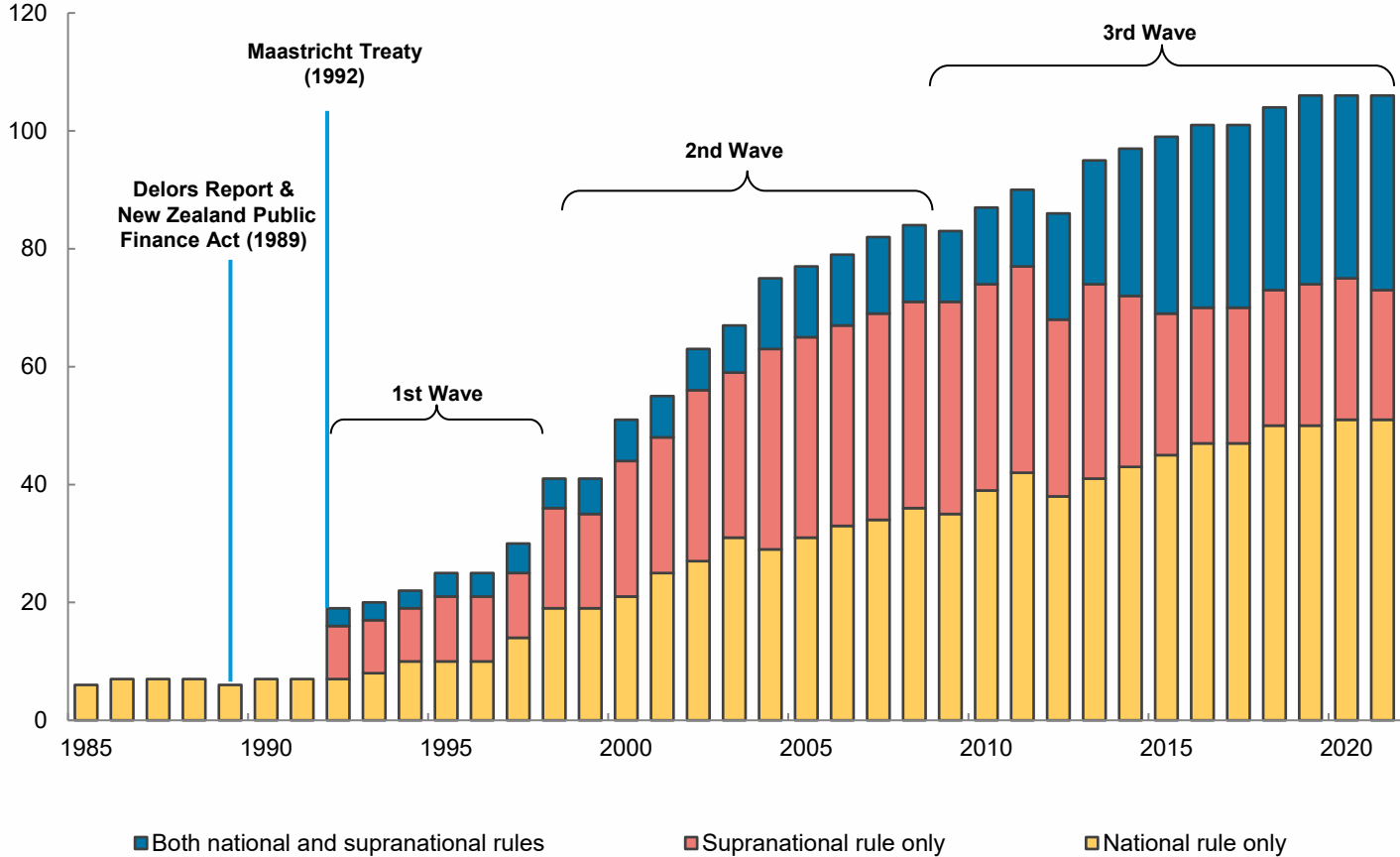
Source: Global Financial Database; Thomson Reuters Refinitiv; Mauro et al. 'A Modern History of Fiscal Prudence and Profligacy', IMF Working Paper No. 13/5, January 2013; IMF Historical Public Debt Database & WEO; IMF Staff Calculations

Note: The values are calculated using a GDP weighted average. The last datapoint is 2019. Inflation and Long-term Interest rates are in percent and plotted to the LHS axis, public debt-to-GDP is in percent and plotted to the RHS axis. The dashed pink line is the 60% public debt-to-GDP reference line.

GFC= Global Financial Crisis; EMU= European Monetary Union.

Global Overview: Fiscal Rules

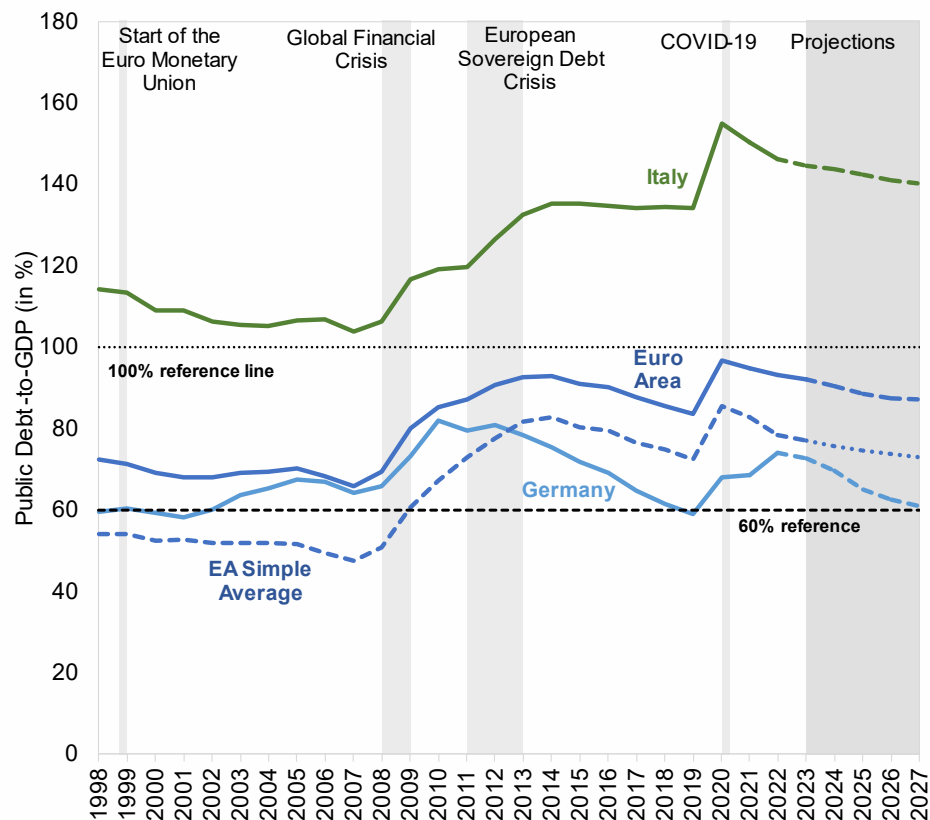
Fiscal Rules on The Rise:1985-2021 (number of countries)



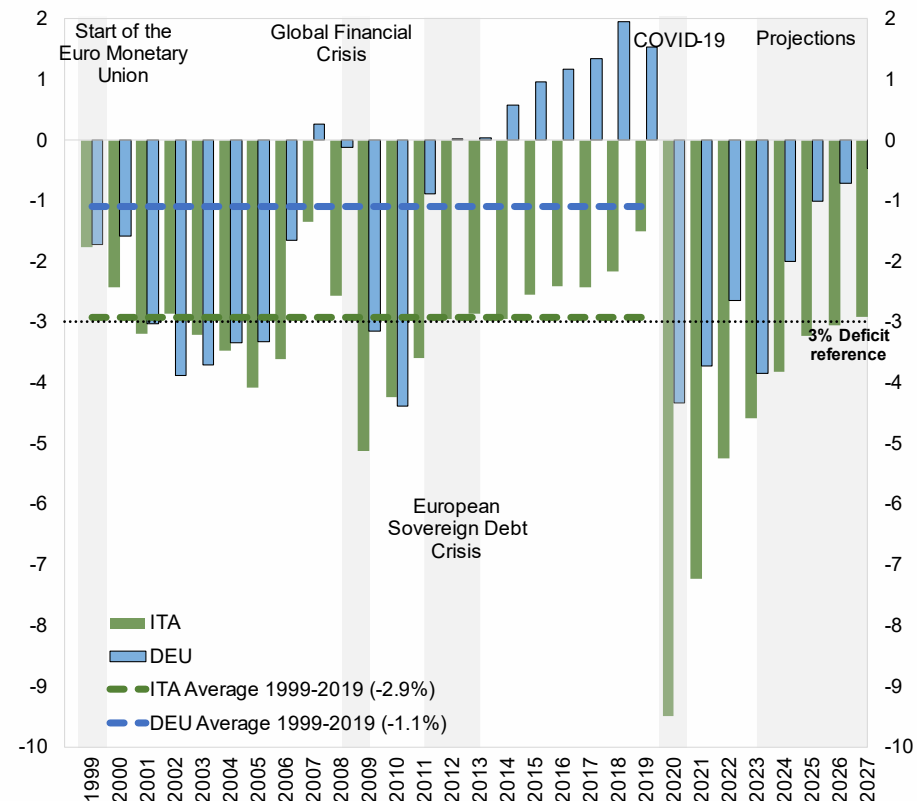
Sources: IMF Fiscal Rules and Fiscal Councils Datasets: 1985–2021.

Debt and Deficits in the Euro Area

Public Debt-to-GDP (in percent) in Italy and Germany (1998-2027)



Overall Balance (in percent of GDP) in Italy and Germany (1999-2027)

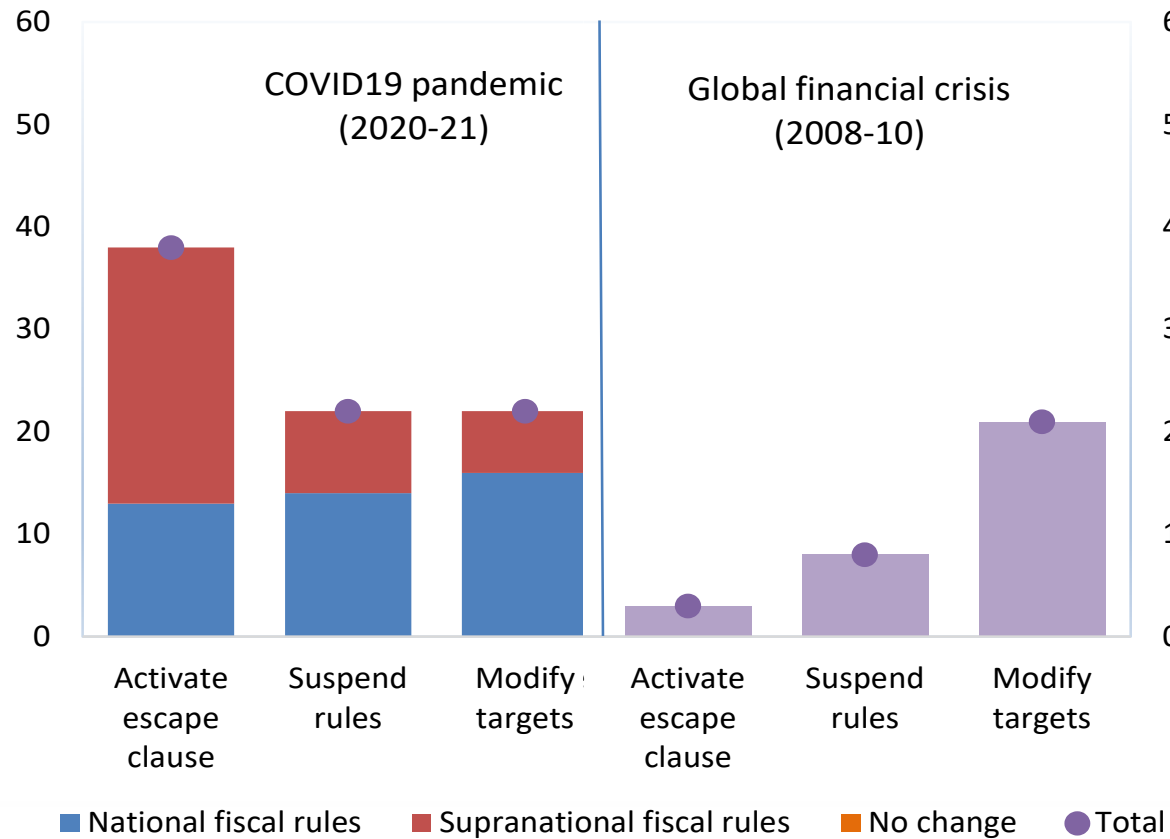


Source: IMF WEO Database (January 2023 vintage) & Staff Calculations

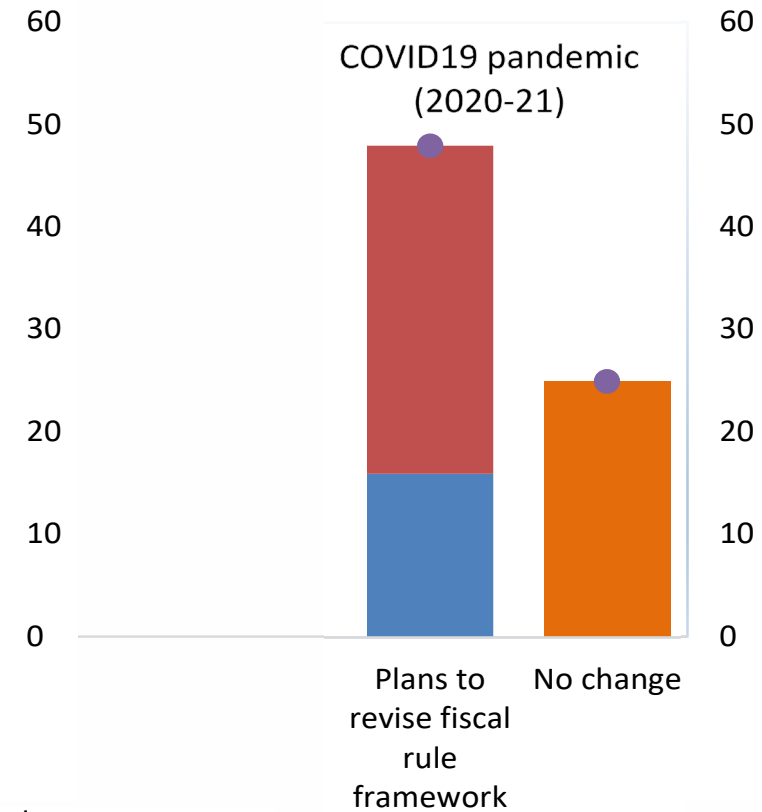
Note: The leftmost chart in panel shows the public debt-to-GDP levels (in percent) for all Euro Area countries. The light transparent lines are other Euro Area countries not highlighted separately.

COVID-19: Escape Clauses and Fiscal Councils

Adjustments in Fiscal Rules during Crises
(Percent of countries with at least one fiscal rule)



Adjustments Planned
(Percent of countries with at least one fiscal rule)

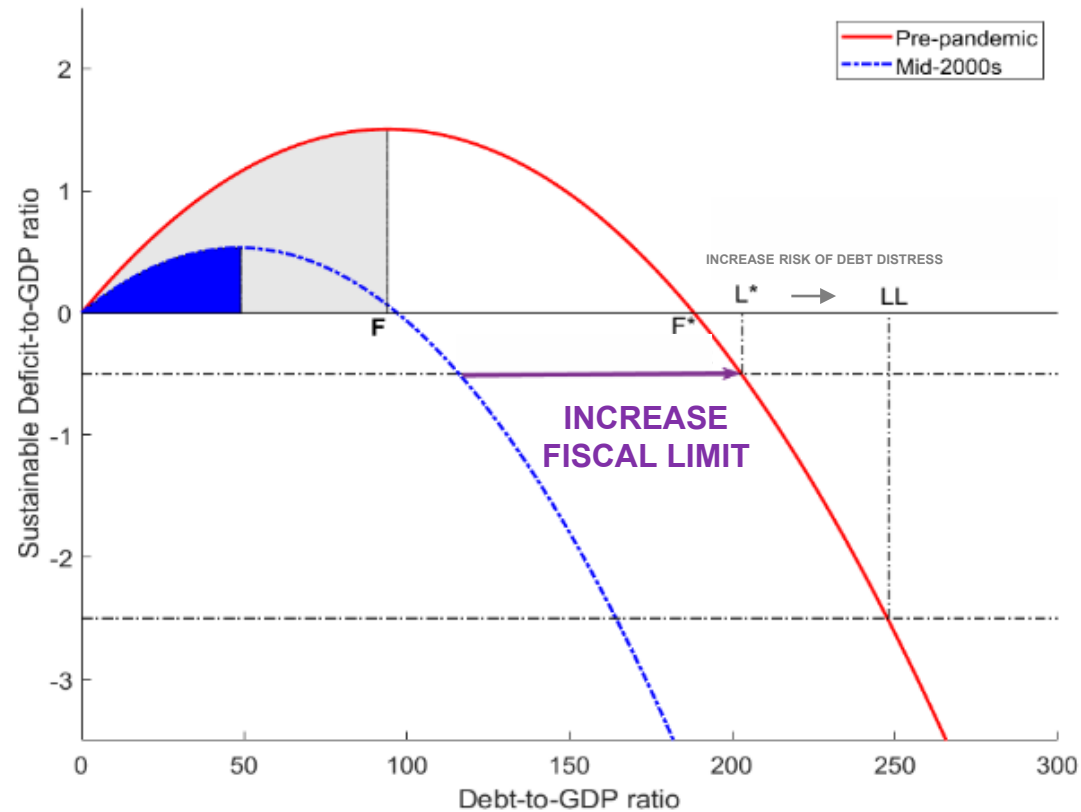


Source: “Fiscal Rules and Fiscal Councils: Recent Trends and Performance during the COVID-19 Pandemic” (Davoodi et al., 2022)

Note: 105 total countries in the database

How Much Can Governments Borrow?

Fiscal Limits Mid-2000s and Pre-Pandemic Advanced Economies



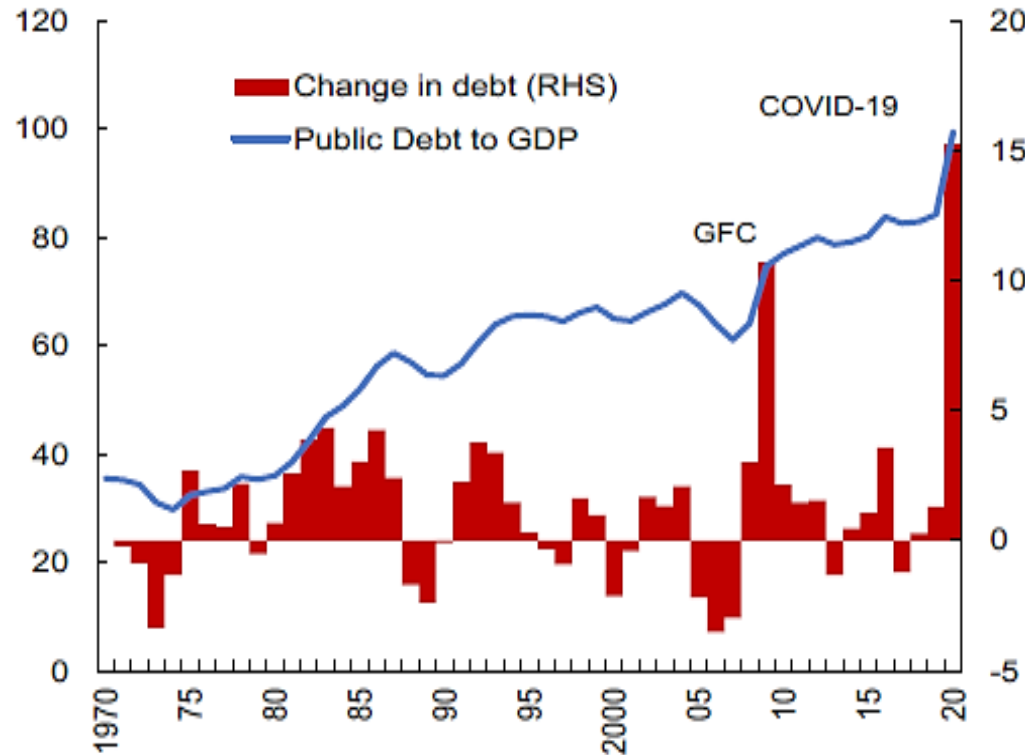
Sources: IMF staff estimates; Mian, Straub, and Sufi (2022).

Note: The estimations are based on the weighted average of each income group, weighted by the size of the economy. The vertical line relates to the maximum sustainable primary deficit and its corresponding debt-to-GDP ratio. The pre-pandemic year uses 2019 data. mid-2000s is from 2000 to 2009.

Larger Buffers Are Needed

Crises and Jumps in Debt

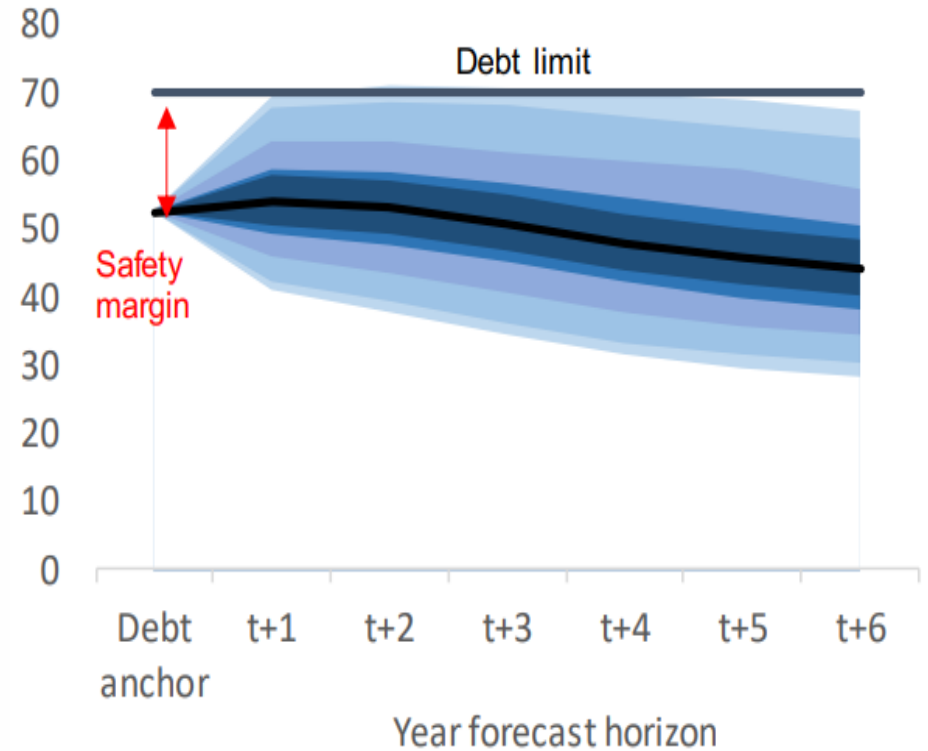
(Percent of global GDP)



Source: IMF Global Debt Database (2022)

Building Sufficient Buffers

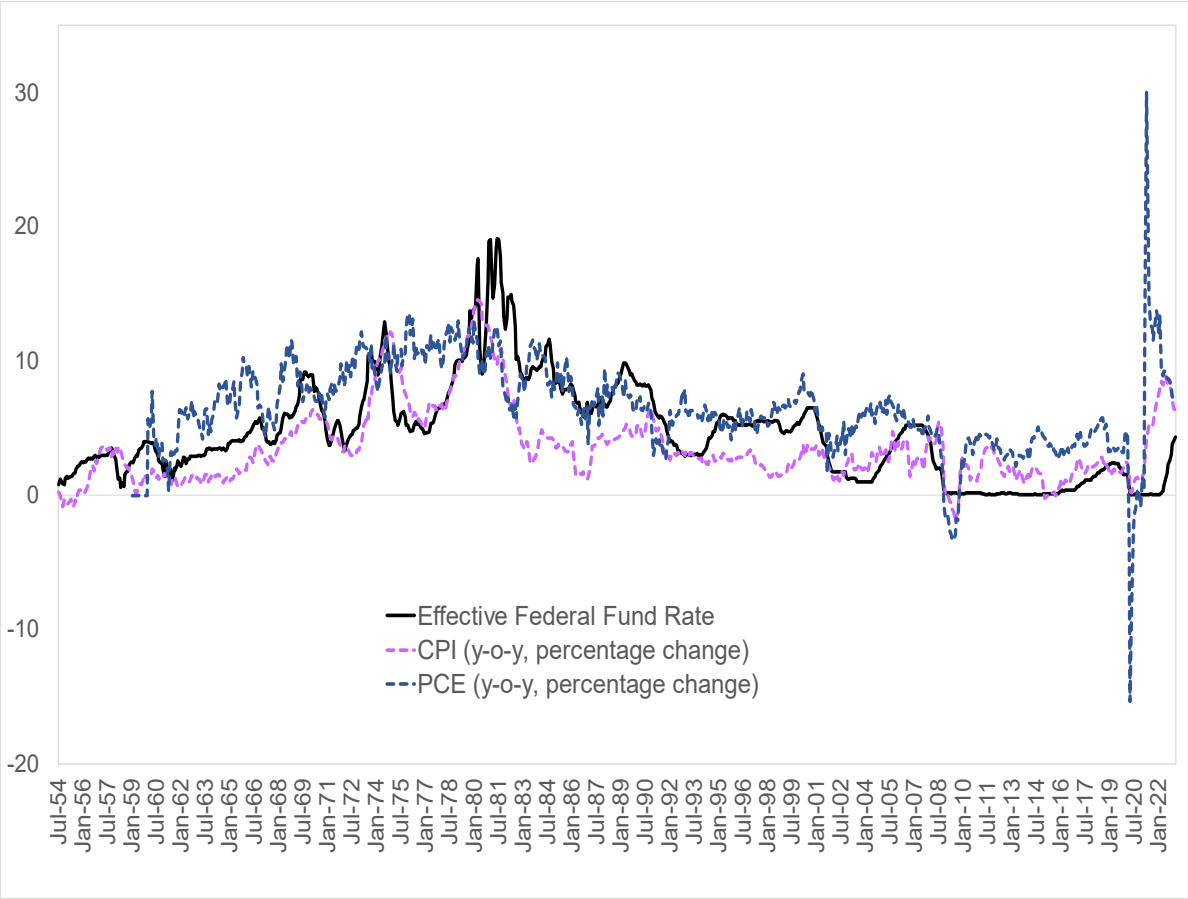
(Percent of GDP)



Source: Caselli and others (2022)

Effective Lower Bound

US Inflation and Effective Federal Fund Rate (1952-2023)



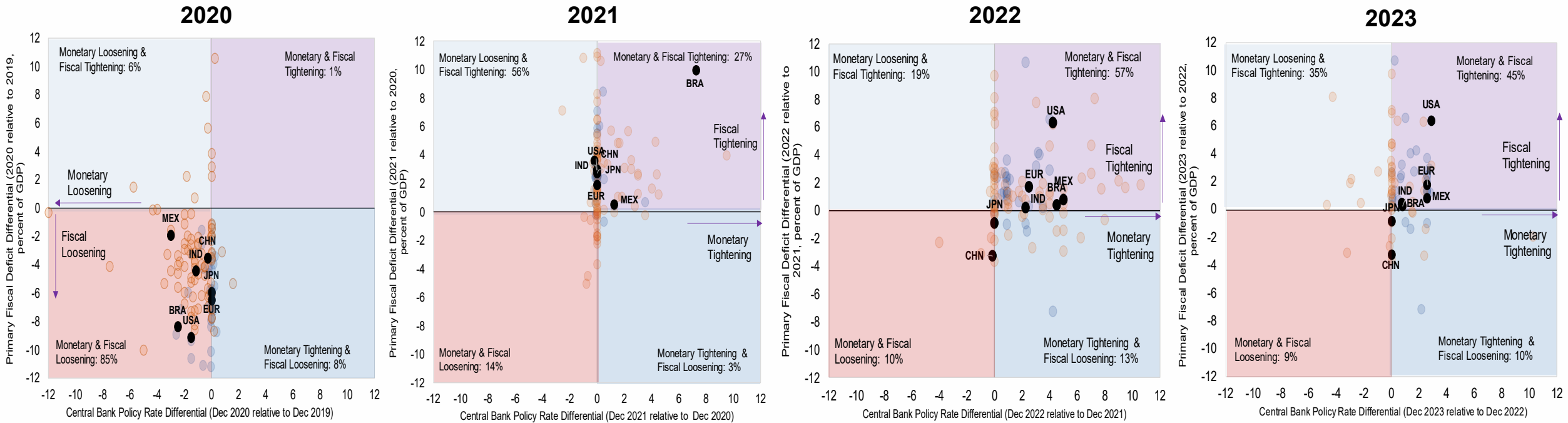
Source: Federal Reserve (FRED)
 Note: Last data point is the month of January 2023. Data in monthly frequency.

Zero Lower Bound (ZLB) or Lower
 (Table sorted by list of country first at ZLB)

Country/Region	At Zero Lower Bound or Lower	In 2020 at ZLB?
Japan	Mar-2006	Yes
Switzerland	Aug-2011	Yes
Denmark	Jul-2012	Yes
Sweden	Oct-2014	Yes
Finland	Jan-2016	Yes
Euro Area	Mar-2016	Yes
Norway	May-2020	Yes

Policy Mix In Exceptional Times

Fiscal-Monetary Interactions in 2020 through 2023



Fiscal Tightening Preceded Monetary Tightening in Most Economies

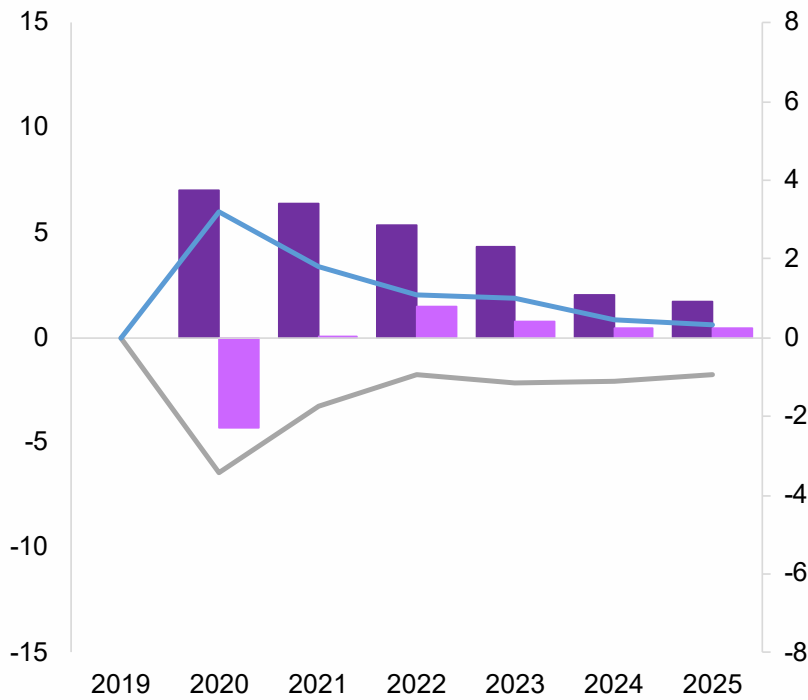


Source: IMF Fiscal Monitor (FM) & World Economic Outlook (WEO) Databases (January 2023); Consensus Economics; National Sources/ Haver Analytics & IMF Staff Calculations

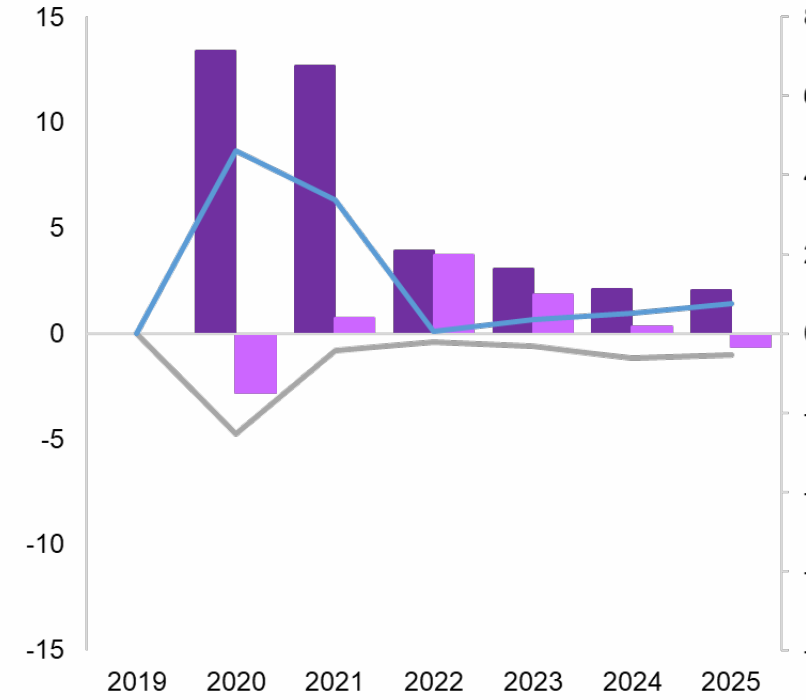
Note: Countries in blue represent Advanced Economies and orange represent Emerging Market & Developing Economies (EMDEs). Aggregates are based on IMF World Economic Outlook classifications. The Euro Area is shown as a singular entity. The rightmost chart uses World Economic Outlook and Consensus Economics forecasts/expectations of interest-rate increases over 2023. Sample points with no change in policy rate (0 differential) are considered not tightening (for labeling purposes to achieve a 100% sample distribution).

Effect of the Pandemic on Revenue, Spending, Primary Deficit and GDP

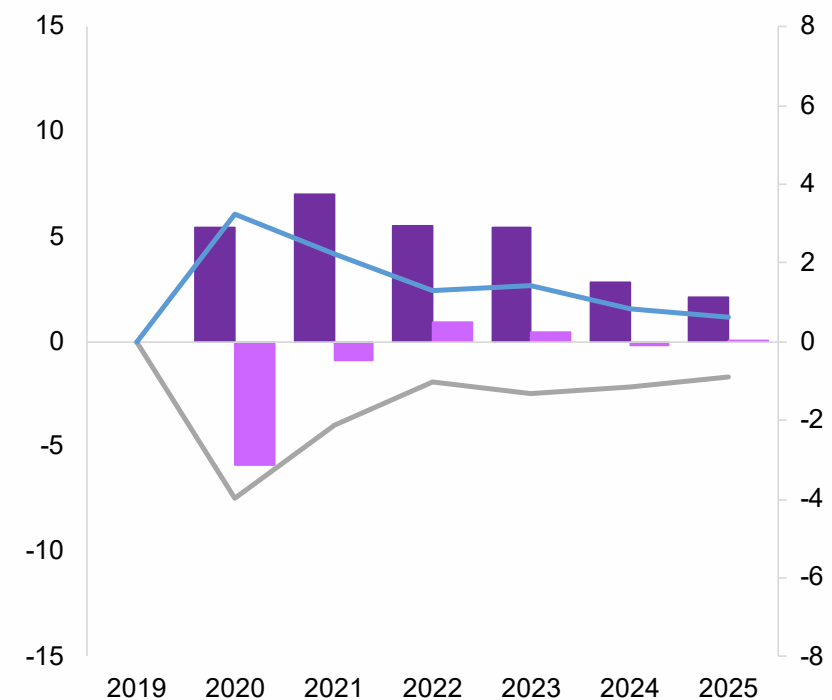
AEs excl US



United States



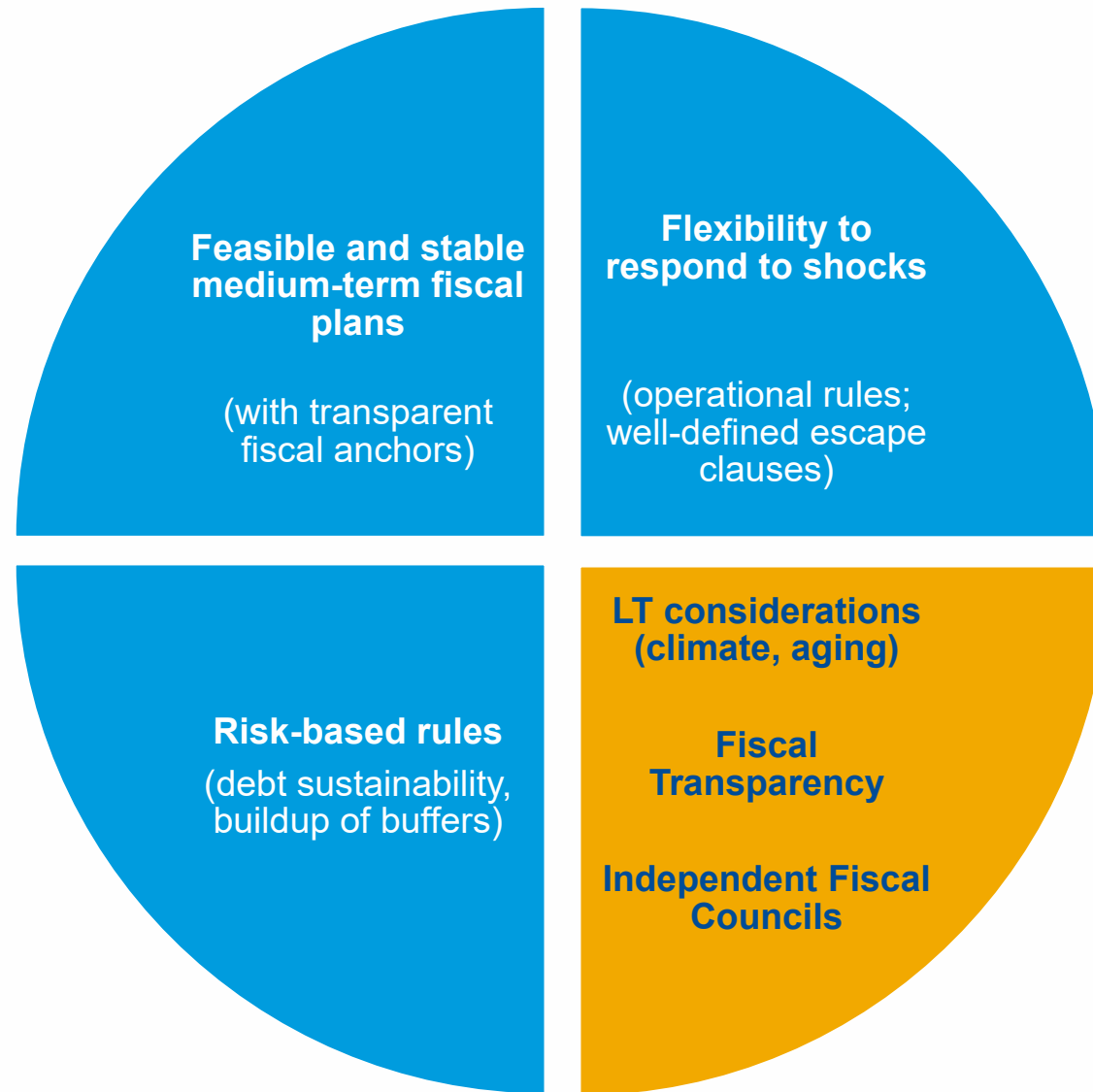
Euro Area



■ Primary Expenditure (right scale) ■ Revenue (right scale) — GDP — Primary Deficit

Source: IMF World Economic Outlook & Fiscal Monitor Databases (October 2019, and January 2023)
 Note: All variables are weighted average real values, deviations from pre-pandemic projections as a percentage of WEO October 2019 vintage projected GDP.

Strengthening Medium-Term Fiscal Frameworks



IMF Staff Proposal for Reforming the EU Fiscal Framework

I. Risk-based rules

- Countries enact **MTFFs with annual expenditure ceilings** that ensure convergence to an **overall balance anchor** over 3-5 years.
- **Link fiscal effort to fiscal risks** identified by DSAs using a common methodology developed by an independent European Fiscal Council (EFC).

II. Strengthen NFCs

- Upgraded national fiscal councils (NFCs) provide **checks and balances for MTFFs**.
- **Revamp Fiscal Reporting**
- **EFC** at the center of a peer network of fiscal councils.
- Surveillance role of **European Commission**.

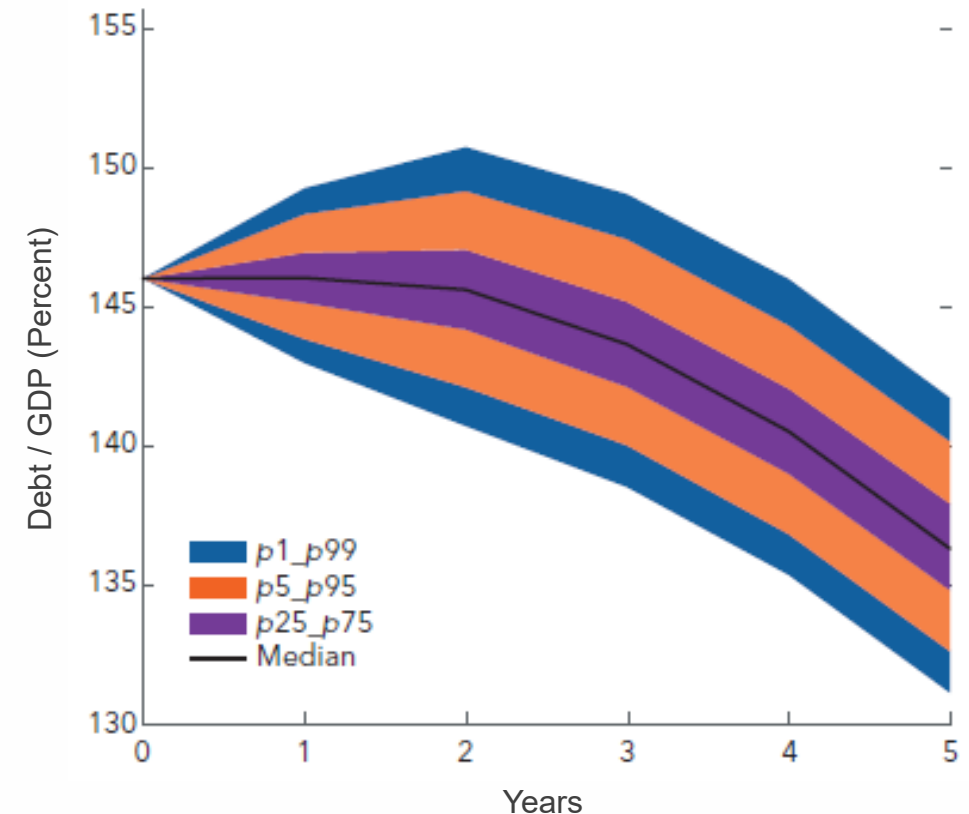
III. EU Fiscal Capacity

- An instrument to **improve macroeconomic stabilization**.
- Provision of **common public goods** at the EU level, including a **Climate Investment Fund**.

New Risk-Based Approach

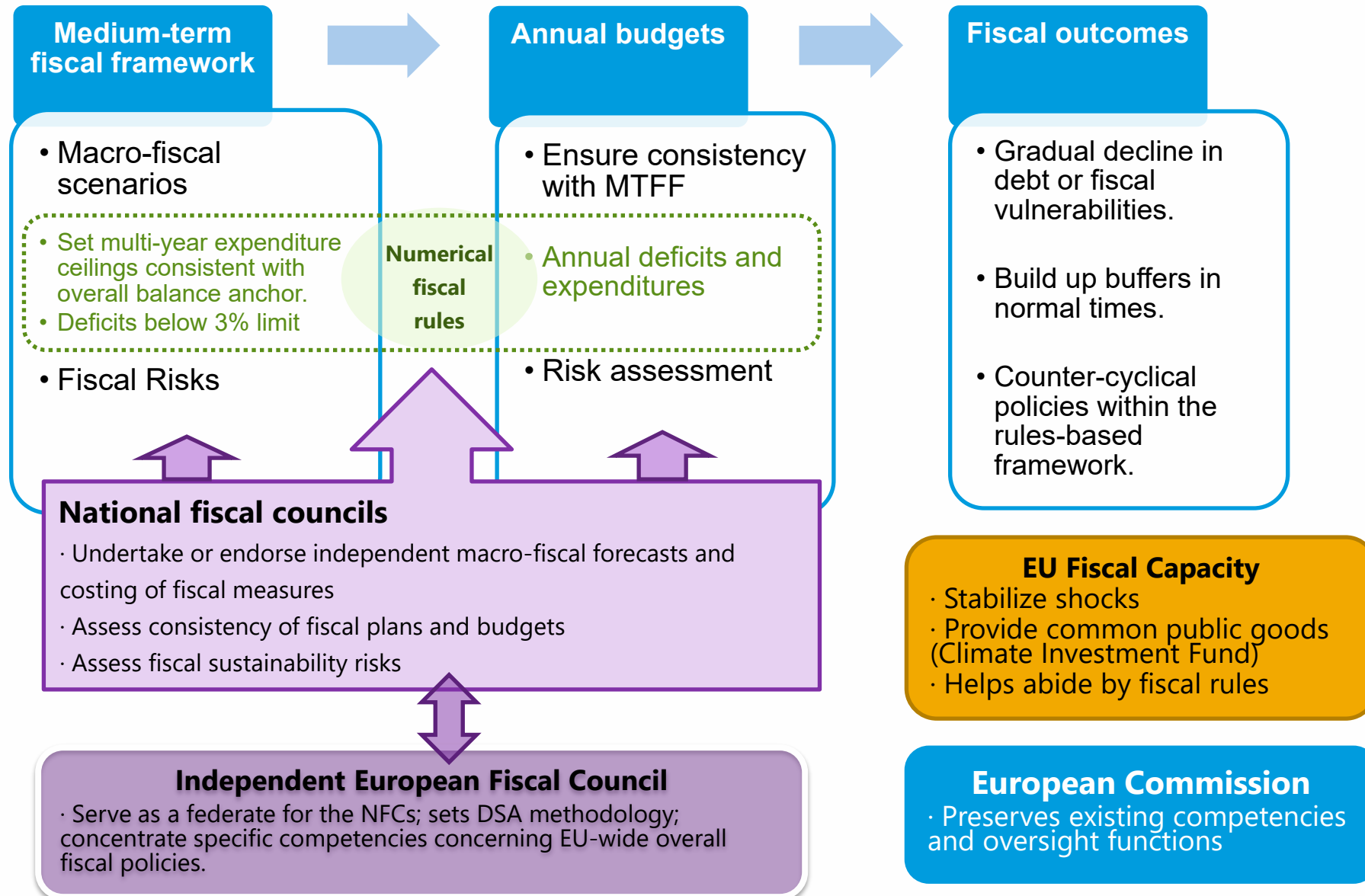
- *Risk-based approach* utilizing DSAs with a common EU methodology.
- Country-specific observable **expenditure ceiling paths** consistent with medium-term **overall balance anchor**:
 - **High risk**: converge to zero or positive overall balance.
 - **Medium risk**: countries choose medium-term overall balance consistent with reducing debt vulnerabilities.
 - **Low risk**: more flexibility when debt below (and forecasted to remain below) 60 percent of GDP.
- *No Treaty change*: Keep 3% deficit ceiling and 60% debt reference value.
- *Well-defined escape clauses* to allow greater flexibility when hit by large shocks and guide the return to the rule.

Italy Debt Ratio, Zero Balance Anchor (Public debt-to-GDP, Percent)



Source: Arnold and others (2022)

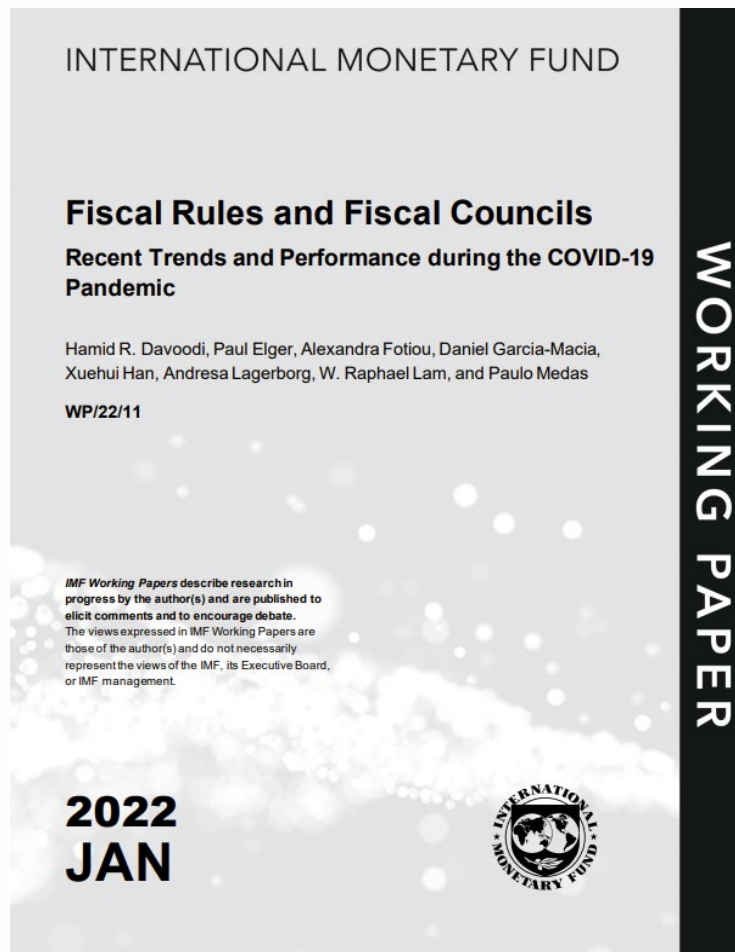
Institutional Implementation



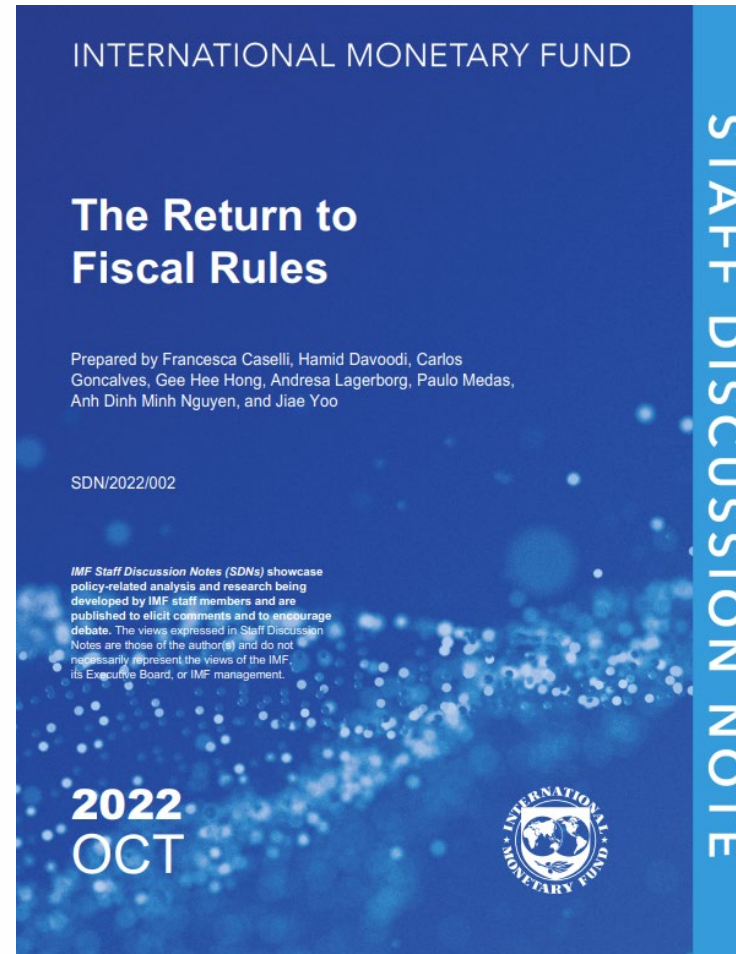
IMF Staff Proposal vs. Current Rules and EC Proposal

	The Current Framework	IMF 2022 Proposal	EC 2022 Proposal
Anchor	3% of GDP overall fiscal deficit ceiling	Yes	Yes
	60% of GDP overall public debt level	Yes	Yes
	Country-specific medium-term objective (MTO) for the structural fiscal balance	Medium-term overall fiscal balance anchor, more ambitious for countries with higher fiscal risks	Medium-term fiscal plans consistent with achieving a declining debt trajectory for the subsequent 10-year period
Operational instrument	Expenditure benchmark based on potential output growth	Multiyear expenditure ceiling paths to reach the medium-term budget balance anchor and to reduce debt vulnerabilities	Multiyear net expenditure path consistent with convergence of debt to prudent levels and deficit remain below 3% over MT
	Minimum structural fiscal balance adjustment if below MTO	No	No
	Debt correction benchmark (1/20th rule)	No	No
Escape clause	Yes	Yes	Yes
Surveillance	European Commission through Excessive Debt Procedure	Yes	Yes
Institutional features	Modest mandate for national fiscal councils and European Fiscal Board	Strong mandate and expanded role for independent national fiscal councils, and a well-resourced and independent European Fiscal Council to replace the European Fiscal Board	Strengthen national fiscal councils; strengthen ex-post enforcement at EU level
	Weak application of medium-term fiscal planning	Strong role for medium-term fiscal frameworks at national level	Adoption of medium-term fiscal structural plans binding on annual budgets
EU fiscal capacity	No	Yes	No

Rethinking Fiscal Frameworks Post Pandemic



Updated Datasets on [Fiscal Rules](#) and [Fiscal Councils](#)
[Recent Trends and Performance](#)



[The Return to Fiscal Rules](#)



[Reforming the EU Fiscal Framework](#)



Thank you