Fiscal Rules in Emerging Markets: What Have We Learned?

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2. What Have Emerging Markets Done? A Lot
3. Has It Worked For Macro Stability in EM? Not Really
4. Recommendations for a New Generation of Fiscal Rules
1.

Why Fiscal Rules?
5 Objectives, 4 Instruments
Objectives and Instruments

- **Revenue Rule**
- **Expenditure Rule**
- **Budget Balance Rule**
- **Debt Rule**

**Fiscal discipline**
- Avoid over-spending
- Avoid over-borrowing
- Avoid over-indebtedness

**Fiscal stability**
- Ceiling on spending growth
- Ceiling & floor
- Ceiling on nominal balance
- Ceiling on CA or structural balance
- Ceiling on nominal debt
- Limits on debt composition (risk)

**Macro stability**
- Ceiling on spending growth
- Ceiling & floor
- Ceiling on nominal balance
- Ceiling on CA or structural balance
- Ceiling on nominal debt
- Limits on debt composition (risk)

**Solvency**
- Pensions, Health
- EU MTOs
- Swedish rule
- Golden Rule
- Limits on debt size, composition (risk), purpose (Golden Rule)
2.

What Have Emerging Markets Done? A Lot
Adopting FR: When

Number of countries with fiscal rules

- Low-income
- Emerging

Source: IMF Fiscal rules database.
Adopting FR: Where

Note: Each region includes emerging and low-income countries. There are no fiscal rules in the Middle East and North Africa region. Source: IMF Fiscal rules database and World Bank.
Preferred FR in EM

Number of fiscal rules in EM

- Revenue rule
- Expenditure rule
- Budget Balance rule
- Debt rule

Source: IMF Fiscal rules database.
Where Do EM Stand Today?

Number of fiscal rules in EM in 2013

Source: IMF Fiscal rules database.
## Objectives and Instruments in EM

<table>
<thead>
<tr>
<th>O / I</th>
<th>Revenue Rule</th>
<th>Expenditure Rule</th>
<th>Budget Balance Rule</th>
<th>Debt Rule</th>
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</thead>
<tbody>
<tr>
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<td>Serbia (2011)</td>
<td>Serbia (2011)</td>
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<td>Macro stability</td>
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<td>Chile (2001)</td>
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<td>Colombia (2011)</td>
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<td>Peru (2000)</td>
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<td>Poland (2011)</td>
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<td>Russia (2013)</td>
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</table>
3. Has It Worked For Macro Stability in EM? Not Really
Has Fiscal Policy Been Counter-Cyclical?

All Countries
(percent of countries in each group)

Emerging Markets
(correlation between gov’t consumption and GDP)


FR Made No Difference

What’s Went Wrong?

✓ Designed with little flexibility
✓ Financial constraints
✓ Politics
✓ Institutions

Notes: BBR = Balance Budget Rule; DR = Debt Rule; ER = Expenditure Rule.
Data for 125 EMDE in 1995-2012.
It’s Not the Rule *Per Se* but Its Design

Some AE introduce **sensitivity to cycle** in budget balance rules

<table>
<thead>
<tr>
<th>Sensitivity to cycle</th>
<th>AE # of countries</th>
<th>EMDE # of countries</th>
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<tbody>
<tr>
<td>YES in BBR</td>
<td>9</td>
<td>6</td>
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<tr>
<td>NO in BBR</td>
<td>18</td>
<td>27</td>
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</table>

Most AE use **exit clauses** in budget balance rules or debt rules

<table>
<thead>
<tr>
<th>Exit Clauses</th>
<th>AE # of countries</th>
<th>EMDE # of countries</th>
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</thead>
<tbody>
<tr>
<td>YES in BBR</td>
<td>22</td>
<td>25</td>
</tr>
<tr>
<td>NO in BBR</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>YES in DR</td>
<td>20</td>
<td>22</td>
</tr>
<tr>
<td>NO in DR</td>
<td>3</td>
<td>17</td>
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</tbody>
</table>

Notes: BBR = Balance Budget Rule; DR = Debt Rule; ER = Expenditure Rule.
Financing Countercyclical Policy

Emerging Markets (correlation between govt consumption and GDP)

Global crisis

Individual EM crisis


Note: Data for 10 EM in 1980-2014.

Less fiscal space (debt > 40% of GDP)
More fiscal space (debt < 40% of GDP)

Note: Data for 63 EM in 2000-2014.
4.

Recommendations For A New Generation of Fiscal Rules
Design

- Make it sensitive to cycle – allow automatic stabilizers.
- Introduce exit clauses – allow discretionary stimulus.
- Require budget surplus (or small deficit) over the cycle to re-build fiscal space – preserve creditworthiness.

- Golden Rule
- Introduce exit clauses – e.g., allow funding of cyclical component of budget balance if debt exceeds its ceiling
- Use potential GDP as scale variable?

- Introduce exit clauses – e.g., allow discretionary spending in bad times even if expenditure growth exceeds its ceiling
- Use potential GDP as scale variable?
Financing and Institutions

**Financing**
- ✓ Build fiscal space

**Institutions**
- ✓ Fiscal frameworks with a medium-term perspective
- ✓ Monitoring and enforcement mechanisms
- ✓ Coherent across tiers of government
- ✓ Fiscal risk mitigation
@Marcelo_WB

Thank you!
Budget Balance Rule

What Balance?
- Overall
- Primary
- Current

Measured How?
- Annual ("Headline")
- Over-the-cycle
- Cyclically adjusted
- Structural

Scaled How?
- % of actual GDP
- % of cyclically adjusted GDP
- % of "Potential" GDP
Expenditure Rule

**What Expenditure?**
- Total
- Current
- Specific Items (e.g., Wages)

**Measured How?**
- Absolute
- Rate of growth
- % of GDP
- Ceiling
- Floor

**Scaled How?**
- % of actual GDP
- % of cyclically adjusted GDP
- % of “Potential” GDP
Debt Rule

What Debt?
- Federal government
- Consolidated government
- Actual
- Contingent

Measured How?
- Stock
- Service
- Composition/Terms

Scaled How?
- % of actual GDP
- % of cyclically adjusted GDP
- % of “Potential” GDP