“Economic Stabilization in the Post-Crisis World: Are Fiscal Rules the Answer?”
by U. Michael Bergman and Michael Hutchison

Discussion by Atish R. Ghosh, IMF Research Department
CONFERENCE NAME, DATE

The views expressed in this presentation are those of the author and should not be attributed to the IMF, its Executive Board, or its management
Fiscal Rules as Post-Crisis Tools

- The global financial crisis pushed up public debt owing to stimulus packages, collapsing revenues, rising spreads, and bank bailouts.
- The IMF provided advice on fiscal space (Ostry et al. 2010), multipliers (Blanchard-Leigh 2013) and consolidation (IMF 2013)
  - Since multipliers are high during crises, countries with fiscal space should back-load their consolidation plans.
- Fiscal rules that credibly promise consolidation tomorrow make stimulus possible today.
- Some pre-crisis evidence provides prima facie support for this claim.
- But more research is needed on how fiscal rules work and how they should be designed.
The authors show that fiscal rules reduce the procyclicality of real government expenditures

- Using data from the World Economic Outlook (IMF 2014), Fiscal Rules Dataset (IMF 2012), and Worldwide Governance Indicators (WB 2013)

Without fiscal rules, real expenditure is strongly procyclical

As fiscal rules get stronger, the procyclicality falls significantly

The impact of fiscal rules depends on government efficiency:

- Specification 1: Linear interaction of government efficiency with fiscal rules. Government efficiency does not have any effect on procyclicality by itself, but does enhance the effectiveness of fiscal rules
- Specification 2: Non-linear interaction. Fiscal rules become more effective when government efficiency is above a threshold level

These results are robust to a variety of controls

Finally, if we focus only on expenditure rules instead of all fiscal rules, the same qualitative results hold
Avenues for Future Work I

- How to operationalize fiscal rules in real time?
  - Difficult to know where we are in the cycle in real time
  - Political economy of dating cycles for FR purposes (UK)
  - Financial cycle versus business cycle—how to treat revenues from asset price inflation?
- Are all rules (expenditure, tax, debt) equally good?
  - Authors combine information on fiscal rules—but are they all equally good for counter cyclical policy?
  - Within a given class of rules, what distinguishes the better rules?
How exactly do fiscal rules interact with monetary policy?
- The authors show that inflation targeting reduces the procyclicality of real government expenditures, but does not change the effectiveness of fiscal rules.
- Perhaps a narrow focus on inflation by the central bank forces fiscal policymakers to play a greater stabilization role; or perhaps the adoption of inflation targeting is correlated with good fiscal policy choices too.
- Which of these mechanisms is operating is important and may vary with monetary policy credibility and the nature of shocks.

How has the procyclicality of fiscal policy changed over time?
- In advanced economies, fiscal policy was assigned a small stabilization role in the Great Moderation period (when monetary policy was active) and a large stabilization role today (when the policy rate is at the zero lower bound).
- Do the regression results differ between the pre-crisis and post-crisis periods?
How do fiscal rules work in booms and recessions?

- The regression results indicate that fiscal rules help reduce procyclicality of real expenditures in recessions but not in booms.
- Suppose that fiscal rules are working through credibility effects (spend more in recessions because a future consolidation is credible).
- But we know that fiscal rules do not reduce real expenditures during booms.
- Then the credibility effect must be rationalized either by an expectation of revenue-based consolidation during the next boom, or by an expectation that the next boom will experience more fiscal consolidation than the previous one.
- Both of these possibilities need to be fully understood.

Do measures of fiscal institutions proxy for deeper political factors?

- If so, transplanting institutions from prudent to profligate countries may not easily work without a concomitant reconfiguration of political power and the preferences of the populace.
- Perhaps only after very large shocks can such institutional transplants work.