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

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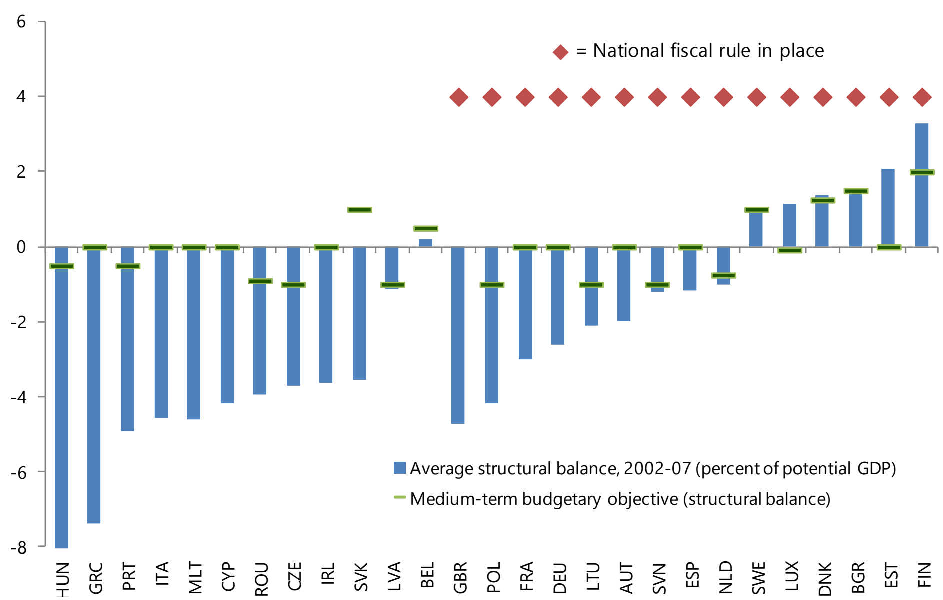
Fiscal Rules as Post-Crisis Tools

- 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



This Paper's Message: Rules Work

- 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?

Avenues for Future Work II

- 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?

Avenues for Future Work III

- 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