

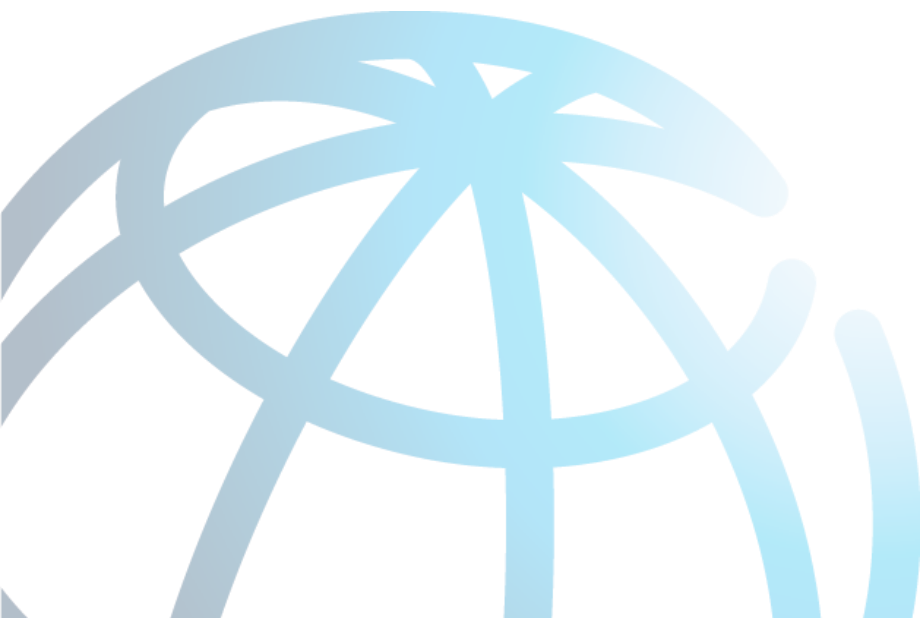
Fiscal Rules in Emerging Markets: What Have We Learned?

Marcelo Giugale

Senior Director

Global Practice for Macroeconomics & Fiscal
Management - The World Bank

Goa, India, December 12th, 2014



Content

1. Why Fiscal Rules? 5 Objectives, 4 Instruments
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

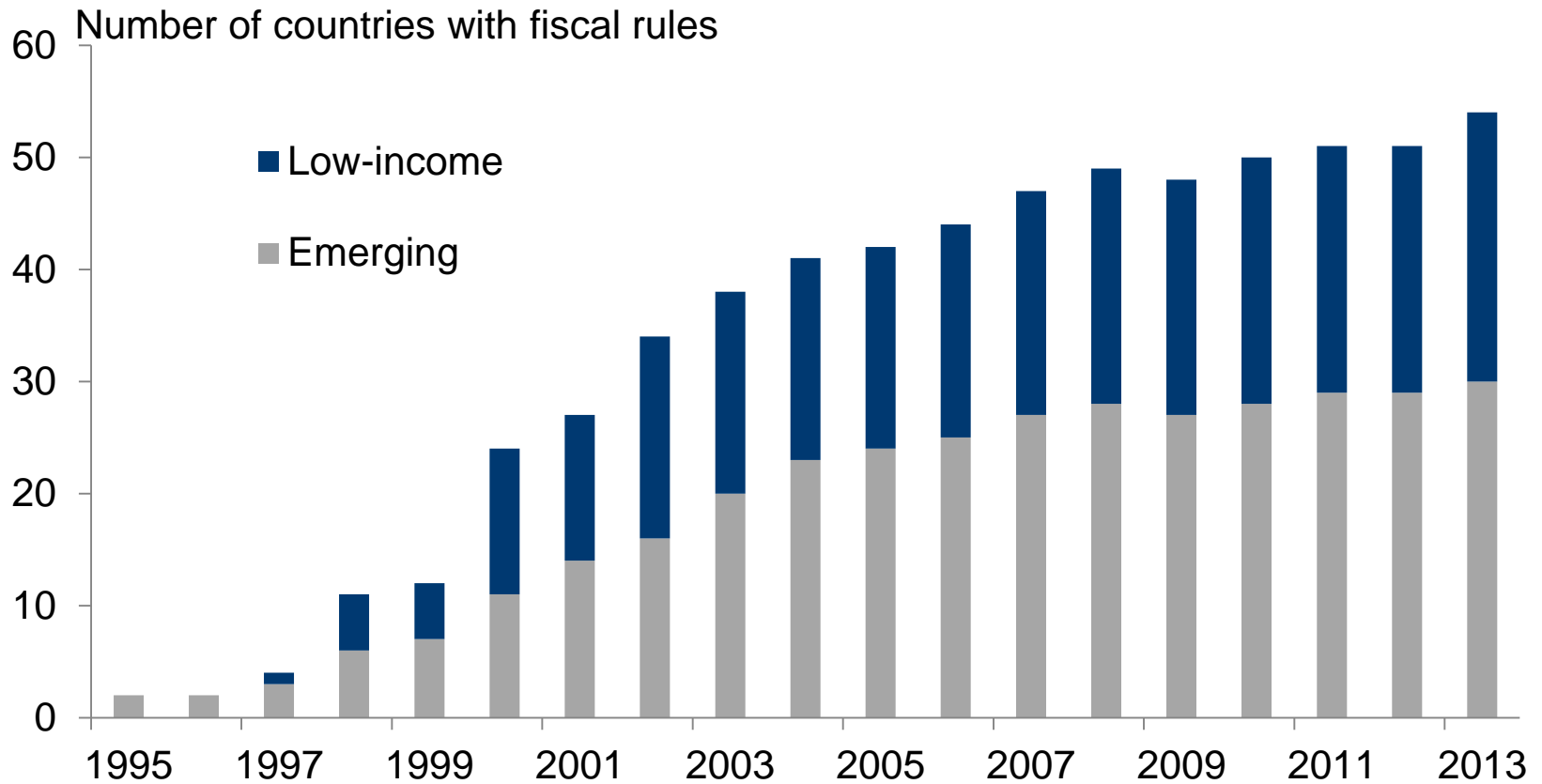
O / I



2.

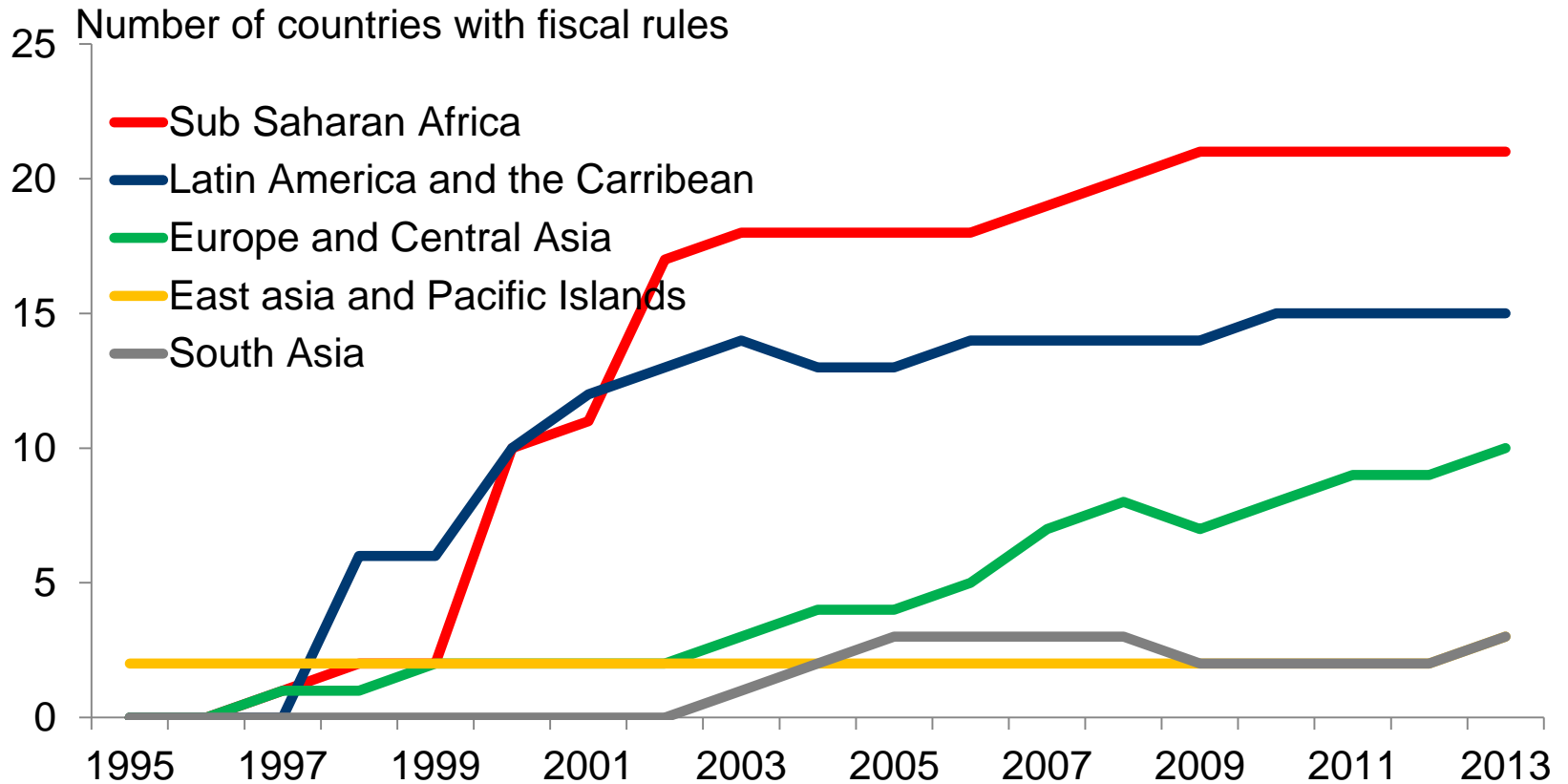
What Have Emerging Markets Done? A Lot

Adopting FR: When



Source: IMF Fiscal rules database.

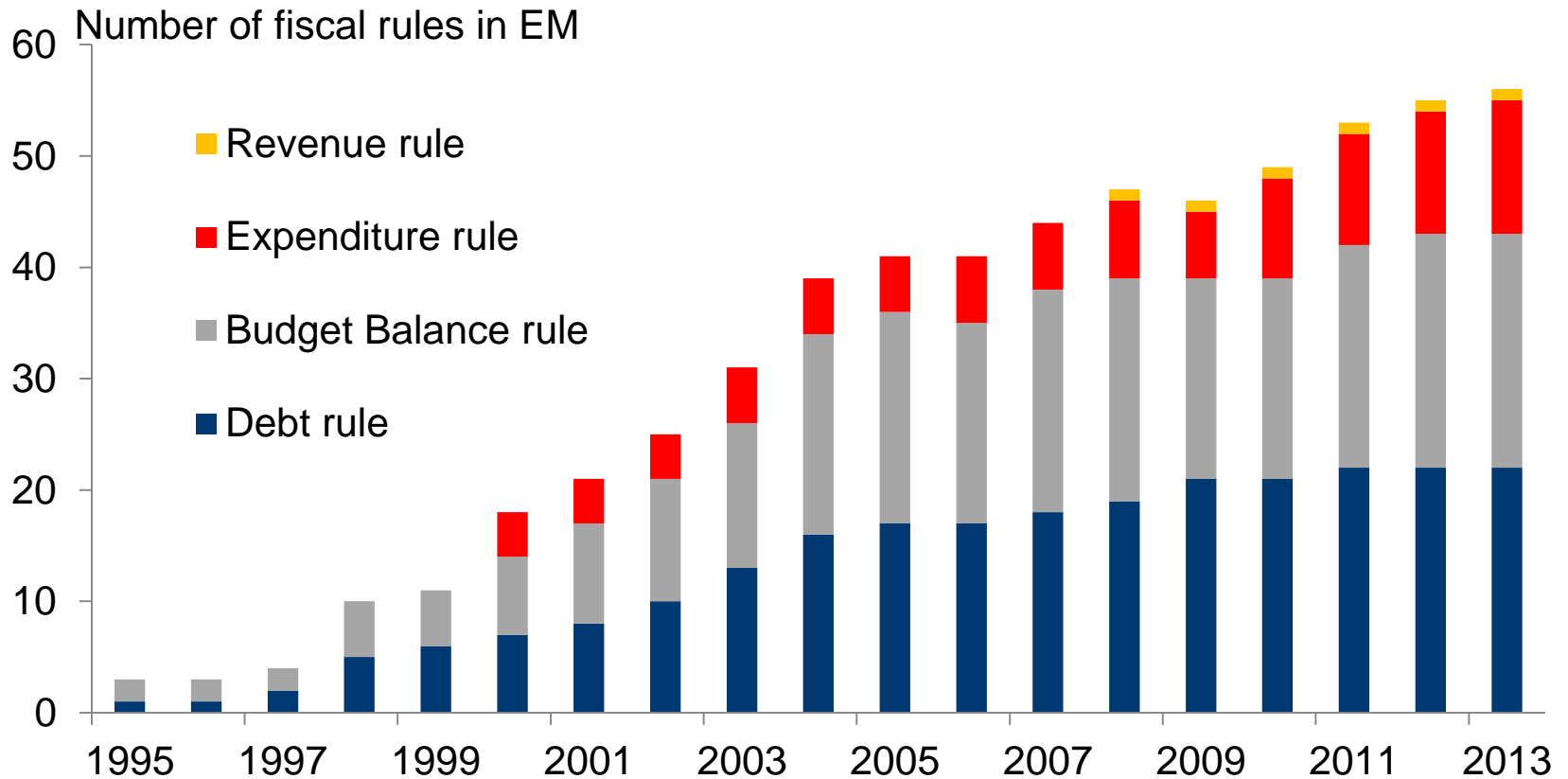
Adopting FR: Where



Note: Each region includes emerging and low-income countries. There are no fiscal rules in the Middle East and North Africa region.

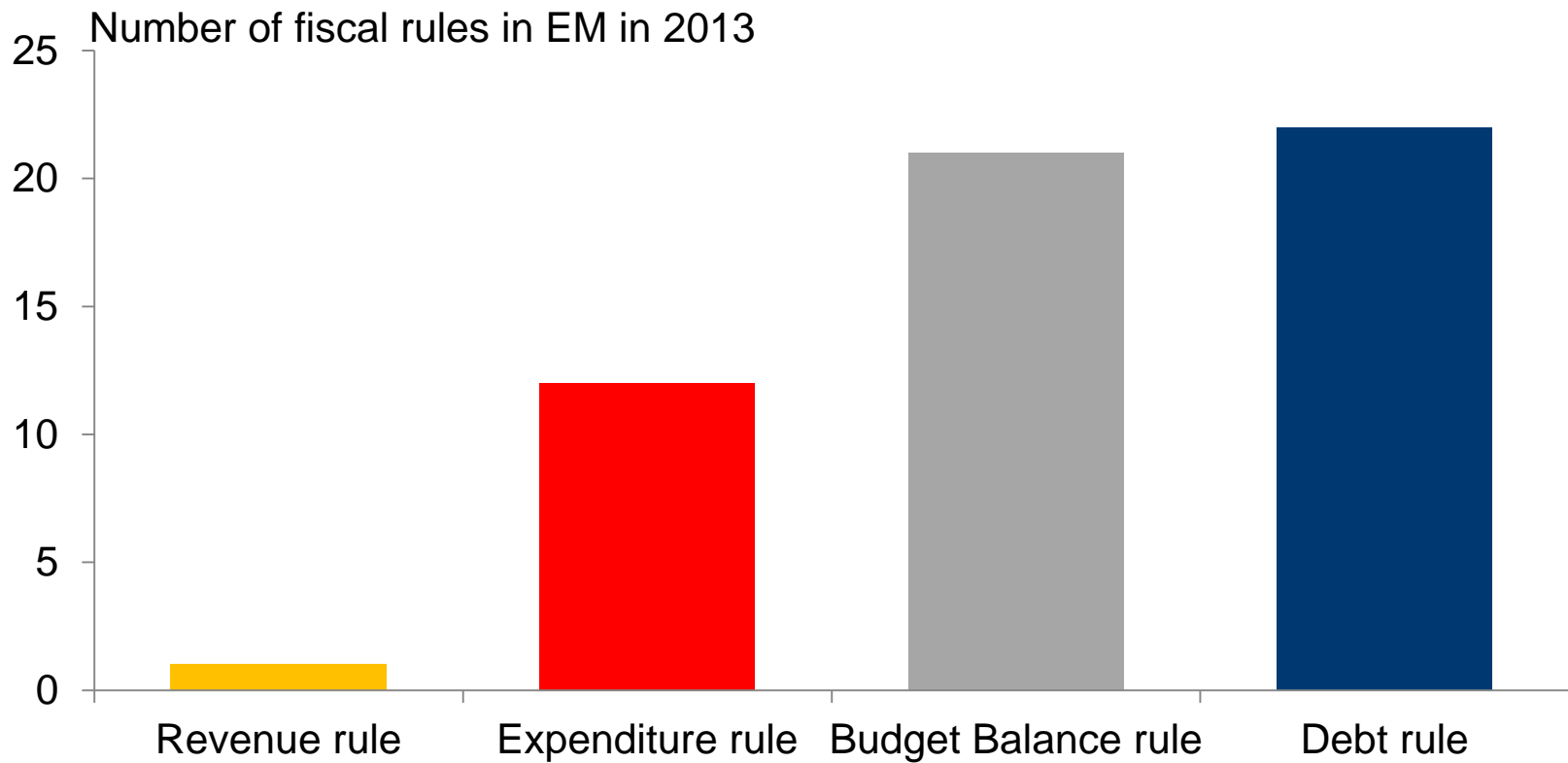
Source: IMF Fiscal rules database and World Bank.

Preferred FR in EM



Source: IMF Fiscal rules database.

Where Do EM Stand Today?



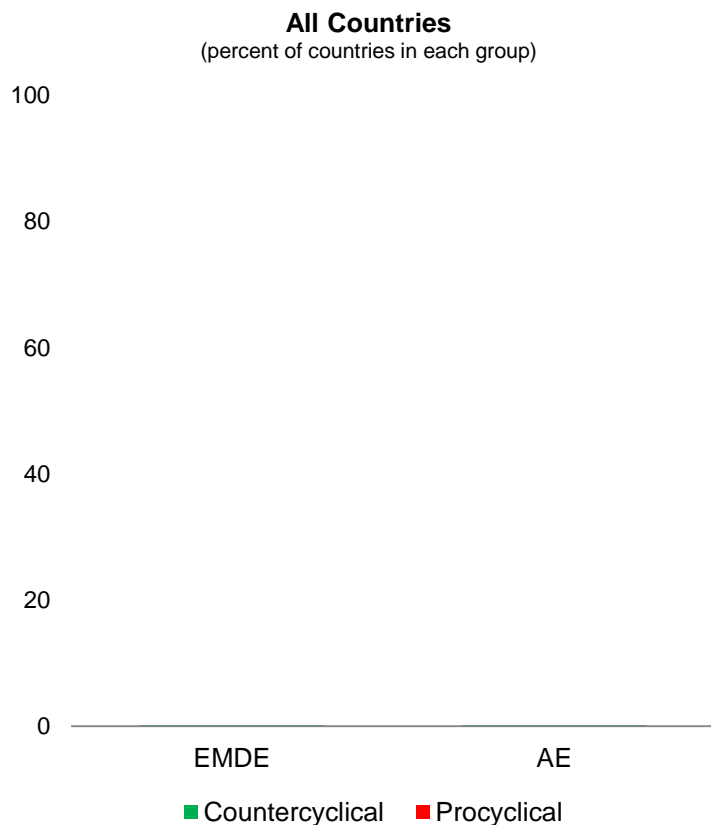
Source: IMF Fiscal rules database.

Objectives and Instruments in EM

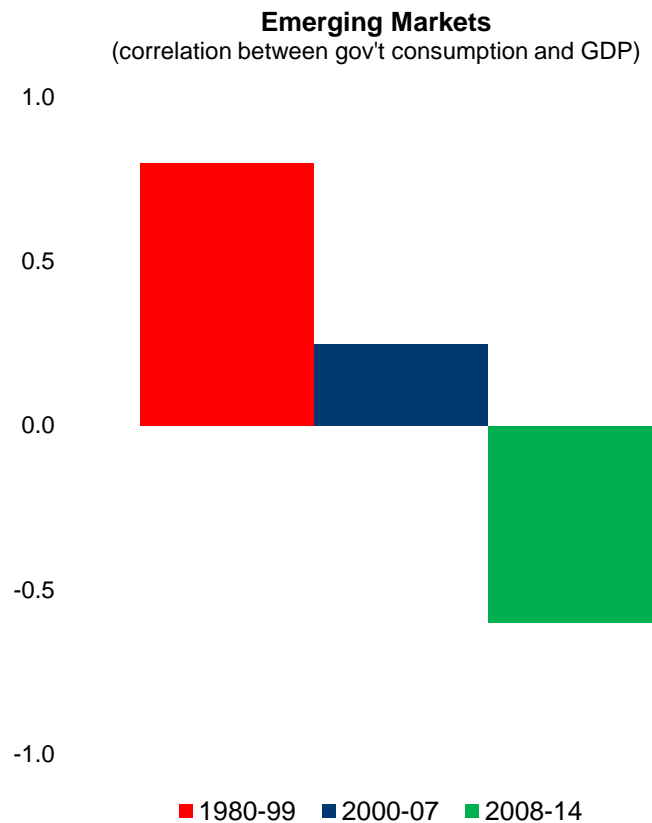
| O / I | Revenue Rule | Expenditure Rule | Budget Balance Rule | Debt Rule |
|--------------------------|--------------|--|--|---|
| Fiscal discipline | | Brazil (2000) Peru (2000) Poland (2011) Russia (2013) | Chile (2001) Colombia (2011) Indonesia (1967) Mexico (2006) Peru (2000) Serbia (2011) | Armenia (2008) Indonesia (2004) Kenya (1997) Malaysia (1959) Poland (1999) Serbia (2011) |
| Fiscal stability | | | Chile (2001) Colombia (2011) | |
| Macro stability | | | Chile (2001) Colombia (2011) | |
| Solvency | | | Chile (2001) Colombia (2011) Brazil (2000, GoldR) Malaysia (1959, GoldR) | Armenia (2008) Indonesia (2004) Kenya (1997) Malaysia (1959) Poland (1999) Serbia (2011) |
| Fiscal size | Kenya (1997) | Brazil (2000) Peru (2000) Poland (2011) Russia (2013) | | |

3. Has It Worked For Macro Stability in EM? Not Really

Has Fiscal Policy Been Counter-Cyclical?



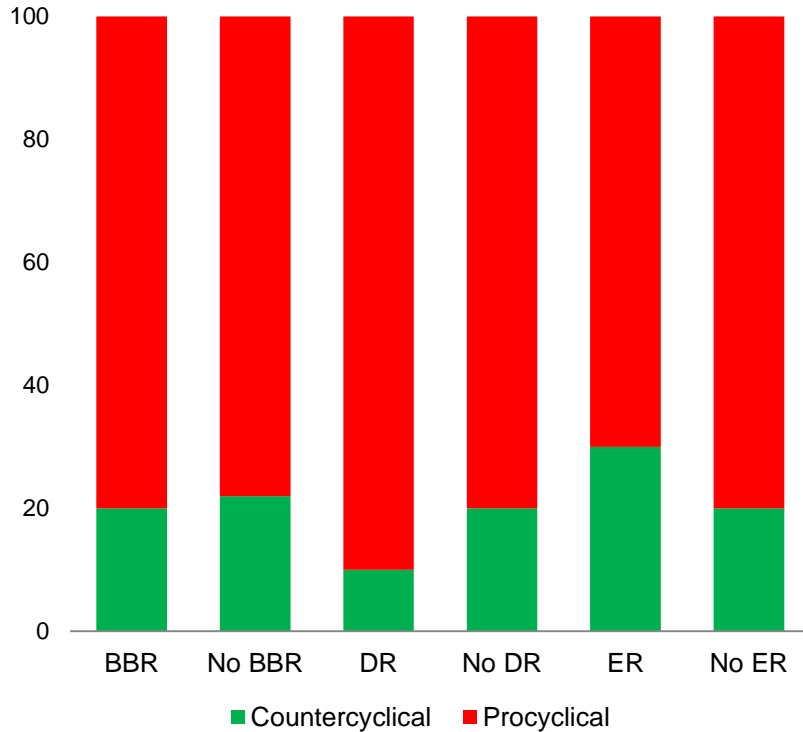
Note: Data for 125 Emerging Market and Developing Economies (EMDE) and 31 Advanced Economies (AE) in 1995-2012.
Source: IMF Fiscal rules database and IMF 2014.



Note: Data for 10 Emerging Markets (EM) in 1980-2014.
Source: World Bank.

FR Made No Difference

Emerging Markets and Developing Economies
(percent of countries in each group)



What's Went Wrong?

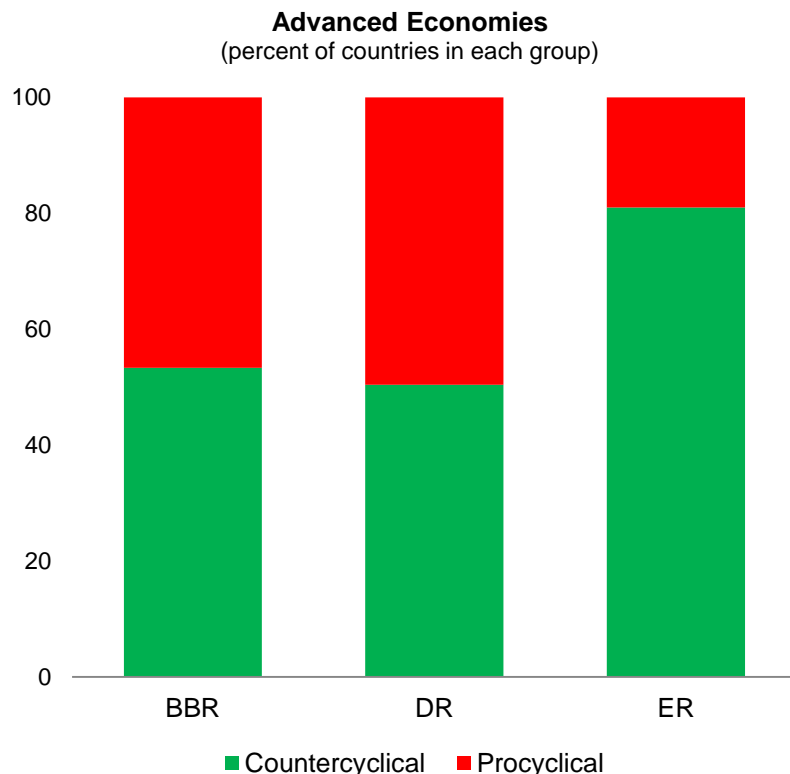
- ✓ Designed with little flexibility
- ✓ Financial constraints
- ✓ Politics
- ✓ Institutions

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

Data for 125 EMDE in 1995-2012.

Source: IMF Fiscal rules database and World Bank.

It's Not the Rule *Per Se* but Its Design



Notes: BBR = Balance Budget Rule; DR = Debt Rule; ER = Expenditure Rule.
Data for 28 AE in 1995-2012.
Source: IMF Fiscal rules database and World Bank.

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

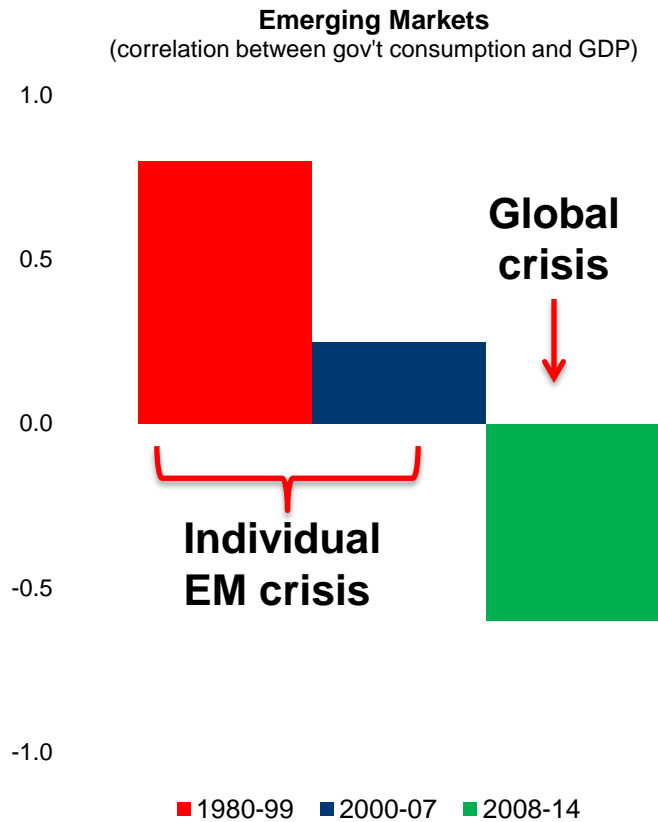
| Sensitivity to cycle | AE # of countries | EMDE # of countries |
|----------------------|----------------------|------------------------|
| YES in BBR | 9 | 6 |
| NO in BBR | 18 | 27 |

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

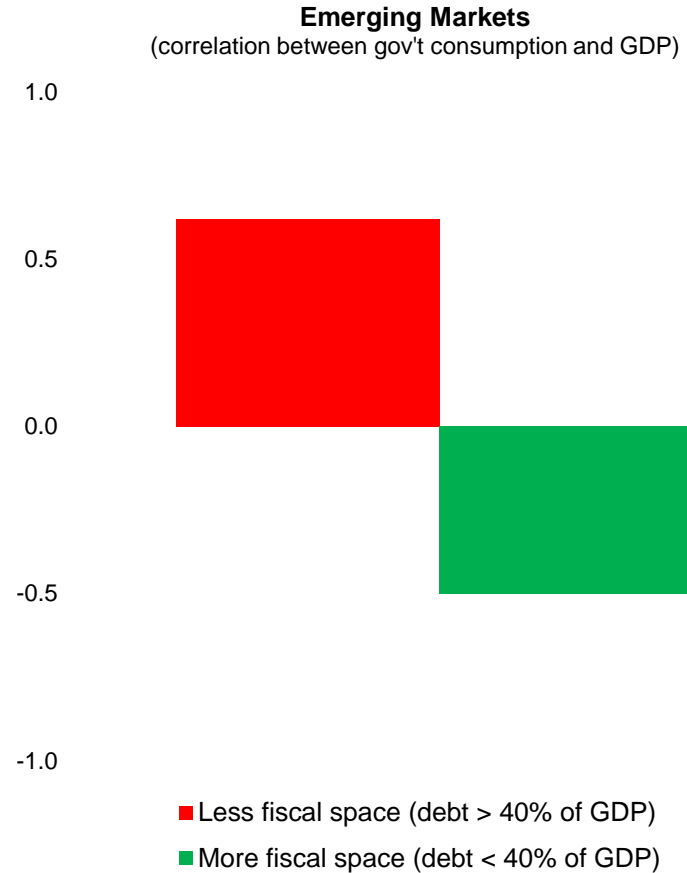
| Exit Clauses | AE # of countries | EMDE # of countries |
|--------------|----------------------|------------------------|
| YES in BBR | 22 | 25 |
| NO in BBR | 5 | 8 |
| YES in DR | 20 | 22 |
| NO in DR | 3 | 17 |

Source: IMF Fiscal rules database and World Bank.

Financing Countercyclical Policy



Note: Data for 10 EM in 1980-2014.
Source: World Bank.



Note: Data for 63 EM in 2000-2014.
Source: World Bank.

4.

Recommendations For A New Generation of Fiscal Rules

Design

Budget
Balance
rule



- ✓ 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.

Debt rule



- ✓ 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?

Expenditure
rule



- ✓ 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

