Fiscal Rules and Large Shocks

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Main objective of fiscal rules is to contain excessive deficits.
A Balancing Act

Cyclically-adjusted balance rules, escape clauses

**Flexibility**

**Simplicity**
Nominal balance rules

**Enforceability**
Sanctions, correction mechanisms, fiscal councils
There have been several reforms since 2008

**Escape clauses**
- Define conditions and period over which rule is suspended
- Adjustment to be applied to revert to the rules
- EU countries, Colombia, Georgia, Jamaica, Tanzania

**Other reforms**
- Correction mechanisms (Grenada, Mongolia, Panama, Peru)
- Independent body monitoring rules (EU, Peru, Kenya, Uganda)
When to activate the escape clauses?

General principles

- Events triggering the activation should be outside government’s control
- Severe economic downturns, large natural disasters, and states of emergency
- The size of the deviation should be linked to the policies directed at the crisis

Pandemic

- Health costs due to crisis
- Large fall in economic activity
- The budgetary impact: automatic stabilizers and discretionary measures
Debt and Deficits

Change in Global Government Debt and Overall Fiscal Balance
(Percentage of GDP)

Sources: IMF World Economic Outlook, National authorities, and IMF staff calculations.

Country Fiscal Measures in Response to the COVID-19 Pandemic
(Percent of GDP)
How to activate the escape clause?

The proposal should preferably explain:
- The reasons for activating the clause
- The period over which the rule will be suspended
- The adjustment to be applied to revert to the rules

Parliamentary approval
- Budgetary impact
- Help ensure the escape clause is being used appropriately

In practice, countries are using different approaches
- Supranational mechanisms
- Supplementary budgets
- Using structural rules or declaring national emergencies
Return to compliance

Procedures to return to compliance

- Appropriate balance to avoid economic disruptions
- Some escape clauses define precise time or conditions to return to compliance with rule

High uncertainty around the pandemic

Effective monitoring and control

- Independent fiscal councils, audit institutions
Good communication is essential

**Credible medium-term fiscal strategy to anchor expectations**
- Baseline scenario
- Risks and possible alternative scenarios

**Regular reports by the government**
- Objectives of all the programs and measures, their fiscal costs, and potential risks to the budget (e.g. contingent liabilities)

**Reports by independent agencies**
Suspending and revising fiscal rules

In the absence of escape clauses: temporary suspend fiscal rules?

- Impede appropriate response
- Follow legal procedures
- Parliament could establish the conditions

Revisions to escape clauses if not flexible enough

Revising fiscal rules?

- Large shock
- Make the rule-based framework more resilient
- There are potential costs to change
THANK YOU!