

Discussion of “Some elements for a revamped fiscal framework for Spain” by Lucía Rodríguez (AIReF)

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SUMMARY:

A proposal to reform Spain's the fiscal framework, based on debt reduction.

Current EU/Spain framework is insufficient to achieve necessary debt reduction:

- EU's preventive arm relies on unobservables / displays weak enforcement.
- National expenditure rule does not ensure convergence to MTO.

Summary of **proposal**:

- **Comprehensive** rule with 3 time dimensions:
 - Long-term anchor & ultimate goal: attainment of a prudent debt level.
 - Medium term: reference level of primary balance set every 4 years
 - Short term & operational target: annual net expenditure growth ceiling.
- **Advantages** over current framework:
 - Transparent: clear single goal based on observables → helps accountability.
 - Consistent: target periodically re-evaluated → ensures reaching objective.
 - Stable: robust to changes in estimated variables → anchors expectations.
- AIReF sets ex-ante and evaluates ex-post the fiscal requirements.

OUR VIEW:

Interesting proposal for a “third generation fiscal rule”,
“broadly fulfilling” IMF's requirements for new reforms of fiscal rules.

ELEMENTS OF DISCUSSION:



I will center my discussion around the following issues:

1. Fulfills IMF's requirements?
2. Robustness to unobservables
3. Need of a counterfactual

1. IMF'S EVIDENCE ON EFFECTIVE RULES



IMF's 5 lessons for fiscal rules from successful frameworks:

1. Broad institutional and economic coverage

Yes, General Government, but potential problems with distribution by sectors.

2. Encourage building buffers in upturns & provide support in downturns

Intermediate target takes into account cyclical position, but operational target is asymmetric allowing only for additional consolidation measures

$$\text{If } IT_{t,t+4} < PB_{t+i}^{t+i-1} \rightarrow FE_{t+i} = 0 \rightarrow NE_{t+i} = E_{t-1} * \prod_{i=0-3} 1 + pot_{t+i}$$

3. Correct calibration is essential to allow for sensible fiscal discretion

Does it allow for the correct amount of stabilization?

4. Well defined escape clauses are crucial to deal with tail events

A more detailed definition would be necessary

5. Supporting independent institutions foster compliance

Yes, but should allow for some space for discretionary fiscal policy, to avoid feeling that a non-elected body completely sets fiscal policy.

1. IMF'S PRINCIPLES FOR REFORMS



These lessons lead to **IMF's general guiding principles** for future reforms:

1. A **holistic approach** is preferable, but should have

- ✓ Anchor public debt for sustainability, only operational rule binds budget.
- X Parsimony, single rules easier to manage, but limiting
- ✓ Consistency, individual rules should not conflict with each other

Is not parsimonious, with 3 dimensions → difficult to communicate & monitor

2. **Simple & flexible** → Expenditure rules are preferred, but

- ✓ Ensures sustainability since it also considers revenues.
- ✓ Escape clauses are crucial, but well defined, with independent scrutiny.

Mix of expenditure operational rule, with intermediate balance rule → takes revenues into account and thus ensures sustainability.

3. **Provide incentives for compliance**

- ✓ Role of fiscal councils
- X Benefits for compliers → e.g.: access to supranational funds

OVERALL COMPLIES WITH IMF'S LESSONS & PRINCIPLES FOR REFORM

2. ROBUSTNESS TO UNOBSERVABLES

The proposal should be clearer about the use of unobservables. It should move from claiming “almost” not using them, to showing it is robust to errors in them.

- Intermediate target uses the **Output Gap** (OG_t to t+4)

$$IT_{t,t+4} = PBN + \varepsilon * OG_{t,t+4}$$

- Operational target uses nominal medium-term **potential** GDP growth (pot t to t+3) & **cyclical** unemployment expenditure (E_{t-1})

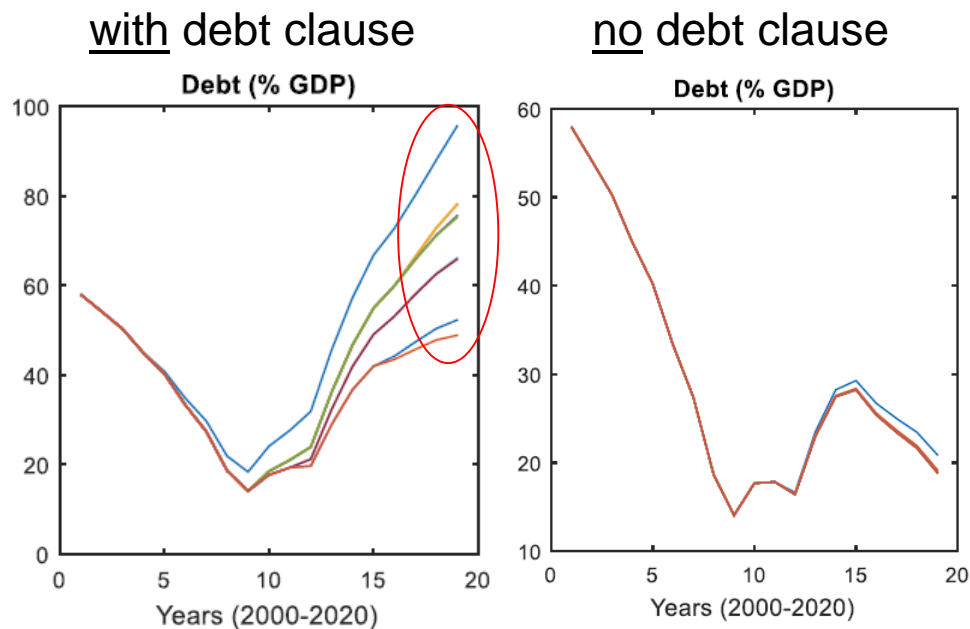
$$NE_{t+i} = E_{t-1} * \prod_{i=0}^3 \left[1 + pot_{t+i} - \left(\frac{FE_{t+i}}{PEXP_{t+i}} * 100 \right) \right]$$

2. ROBUSTNESS TO UNOBSERVABLES (CONT.)



However, to claim robustness to real time forecast errors in unobservables a more thorough assessment is necessary.

- Paper reports impact of Output gap errors on debt, with sizable impact (50-95%), when debt clause is active.
- Should also compare with impact of OG in alternative frameworks (SGP's structural effort)



- Should show also impact of errors in nominal potential GDP growth (inflation & real components) & in cyclical unemployment.

3. NEED FOR A COUNTERFACTUAL



A counterfactual showing PROS of proposal over current framework is needed.

Comparing with data, as in the paper, mixes CONS with lack of compliance.

Construct a counterfactual of Preventive Arm using a simple DSA framework:

Debt dynamics
$$b_t - b_{t-1} = \left(\frac{r_t}{1+g_t}\right) b_{t-1} - \left(\frac{\pi_t+g_t}{1+g_t}\right) b_{t-1} - p_t + add_t$$

Growth eq
$$g_t = \rho g_{t-1} + (1 - \rho)\bar{g}_{t-1} - \beta_1 \Delta d_t^E - \beta_2 O_t - \beta_3 (r_t - r_{t-1})$$

Phillips Curve
$$\pi_t = \vartheta_0 \pi^0 + (1 - \vartheta_0) \frac{1}{4} (\pi_{t-1} + \pi_{t-2} + \pi_{t-3} + \pi_{t-4}) + \vartheta_1 O_t$$

Interest rate
$$r_t = \varphi_r r_{t-1} + (1 - \varphi_r) \{ (1 - \varphi_r^c) r_t^L + \varphi_r^c r_t^C \}$$

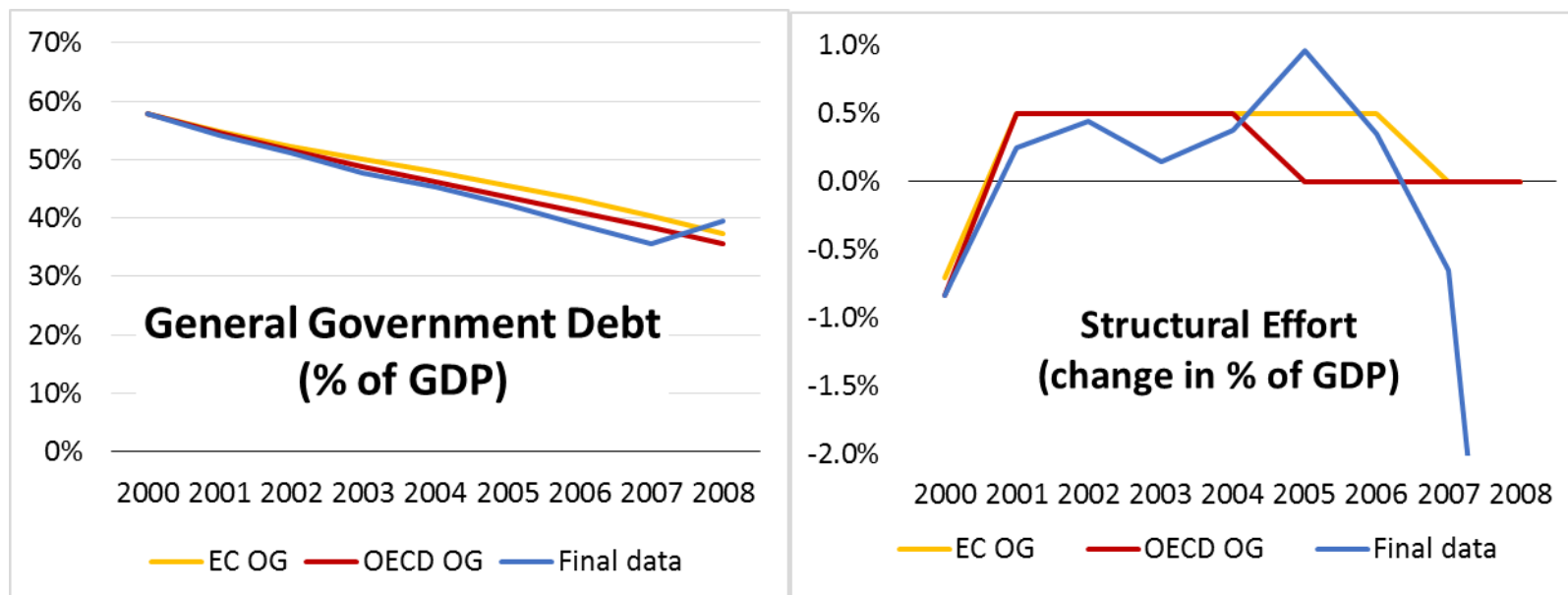
Long-term rate
$$r_t^L = r_{t-1}^L - \tau_d \{ d_{t-1} - \bar{d}_t \} + \tau_b \{ b_{t-1} - \bar{b}_t \}$$

3. NEED FOR A COUNTERFACTUAL (CONT.)



Preventive Arm: 0.5% structural effort until MTO is reached (structural balance)

With ex-post data and estimated OG the rule delivers debt < 40%, in line with observed structural effort

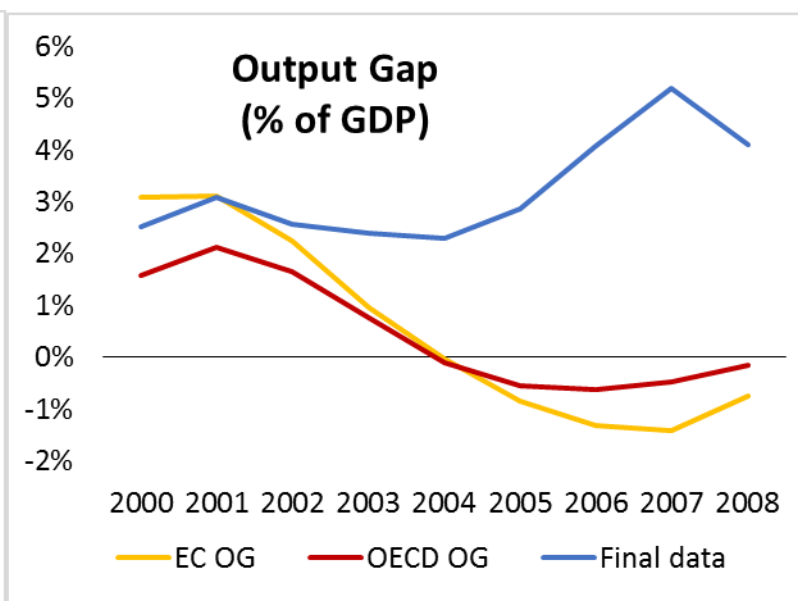
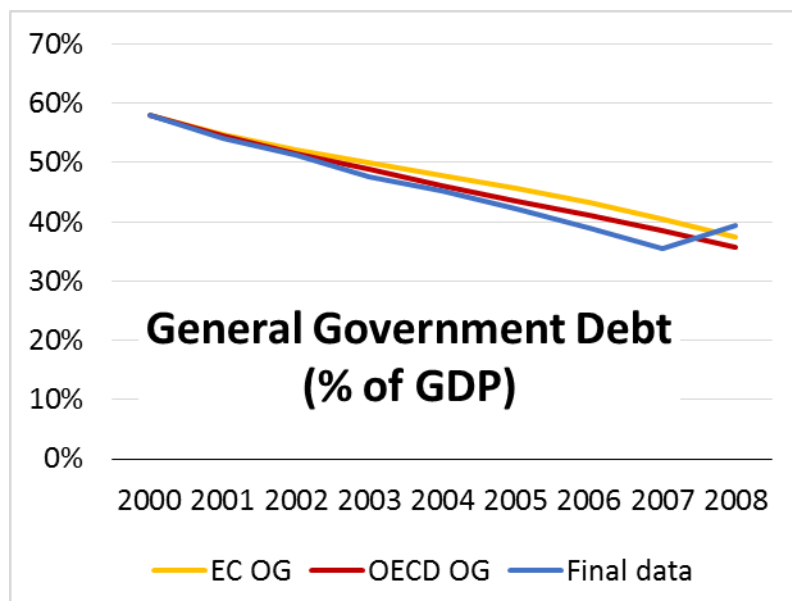


3. NEED FOR A COUNTERFACTUAL (CONT.)



Preventive Arm: 0.5% structural effort until MTO is reached (structural balance)

With ex-post data and estimated OG the rule delivers debt < 40%, in line with observed structural effort, but with much lower output gap.



This should be compared with Airef's rule & repeated with real time data



THANK YOU FOR YOUR ATTENTION

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