COMMENTS ON SESSION I: THE PROS AND CONS OF FISCAL RULES

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1. Introduction

The papers presented in this session provide very important insights into the history, role and conditions for the proper functioning of rules. Two types of rules were identified – numerical rules, including e.g. the SGP deficit rule, and procedural rules on transparency, enforcement etc.

An important question raised in these papers was when do rules work? It was argued that rules and their objectives must be clear, simple and the outcome measurable as compared to the target. Transparency, monitoring and enforcement must be secured, and rules must be hard to change. The institutional framework in which rules are imbedded is crucial to insure their "success". The following comments try to pick up some of these themes as discussed in individual papers.

2. Reputation versus rules for fiscal discipline

George Kopits paper provides an excellent discussion of the "pros and cons" of fiscal rules. I only have one small quibble regarding the possible substitution between rules and reputation to safeguard fiscal discipline. George argues that rules should come first, but that over time reputation may make rules unnecessary. Germany and Japan are mentioned as examples for this. I would disagree. In the political market, reputation is not necessarily an equally strong incentive for "good" behaviour as in private markets. In the private market, principals (share holders) can dismiss agents (managers) at any time and reputational capital may be protected that way. In politics, an election victory provides a four year franchise and agents can not do anything if they feel cheated until the next election.

[*] European Central Bank. The Comment reflects the personal views of the author and not those of the European Central Bank.

Governments may squander a reputation of tight fiscal policies if they think that short term fiscal profligacy would help to win the next election and another four year franchise. Germany is perhaps an example of this. In Germany, the 1970s witnessed relatively high fiscal deficits. This followed (amongst other reasons) the erosion of the golden rule. In the 1990s, the golden rule was circumvented through special funds. In both periods, reputation was no reason to keep fiscal discipline. This potential failure of reputation as a disciplining device is an important argument why rules should be hard to amend/circumvent.

3. Clarity of rules in practice

As to Andrew Kilpatrick's paper, I am intrigued by its upbeat rhetoric. Only time will tell whether the combination of numerical and procedural rules applied in the UK warrants such optimism and I have my doubts. The paper stresses the importance of clear objectives and transparency. But reading carefully, there is more vagueness in the rules than it is claimed. The paper talks about the requirement of “prudent” debt levels but what prudence is seems to be decided by government. There is more vagueness when it is argued that government is to provide "support to monetary policy through changes in the fiscal stance where prudent and suitable”. “Sensible discretionary policies” are also mentioned as part of the government’s fiscal strategy elsewhere in the paper. Moreover the formal rules (e.g. the golden rule) are not ambitious and have proven to be quite soft in other countries that applied them.

4. Rules beyond macro targets

I do not have specific suggestions of improvements for the Paul Atkinsen and Paul Van Den Noord's study. But as a more general comment, so far we have focussed mostly on rules which take away macro discretion from policy makers. The Atkinsen/Van Den Noord paper focuses on public expenditure and how the consolidation framework could also help to obtain leaner and more efficient government. This is very interesting and important. It raises the question whether we should also have rules for other aspects of public finances. Should we have rules specifying certain functional expenditure levels, distributional or social objectives, even employment rates or minimum growth rates? There is certainly a tendency in this respect in the policy arena. This topic is worthwhile discussing but moving in this direction also bears risks:

- the objectives may not be easy to specify and may not be clearly linked to fiscal policies alone
- the objectives may be unrealistic and politicised and may even discredit rules more generally.

The paper also does an excellent job in discussing the importance of different ways by which expenditure policies can achieve more efficient government. Let me just mention vouchers in education where the debate focuses on how best to achieve high education standards. Government could be the provider or just the financier of "public" goods and services such as education. Here the question arises whether certain activities should be done by the private or the public sector "as a rule". The question may be easy to answer for airlines (private) or the military (public) but the "right" approach in education is not obvious and probably depends very much on the country circumstances.

5. Implicit and contingent liabilities

My final comment once more refers to the tendency towards rule erosion and circumvention. If you have a deficit limit as your only constraint on fiscal policies why not move activities off budget? This could take the form of financing items or contingent/implicit liabilities. The Atkinsen/Van Den Noord paper briefly discusses this issue and there is an emerging literature elsewhere. However, there is still very limited understanding of this domain. This is made worse by lack of transparency in government financial and off-budget accounts. Contingent and implicit liabilities are often not accounted and provisioned for.

Here procedural rules seem important again, including the application of modern accounting rules and high transparency standards for the government. Numerical targets, such as a prohibition of government guarantees and off-budget accounts, could be imagined.

The growing importance of implicit liabilities is well recognised, e.g. in the debate on ageing and implicit liabilities from the financial system. The costs to government, if such liabilities have to be covered by the fiscus, can be very high. A better understanding of implicit and contingent liabilities and how to apply rules to control such liabilities seems a research area warranting more attention from the fiscal perspective in the future.