COMMENTS ON SESSION II: EUROPEAN FISCAL RULES

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Together, these papers provide a rich base on which to discuss the various conceptual and operational issues surrounding fiscal rules. Rather than comment on each paper separately, however, I will instead use some of the contributions to introduce a few considerations that might merit more discussion, here or in future research.

For participants in Economic and Monetary Union (EMU), there are at least two key and related reasons for wanting countries to adopt their own internal operational fiscal rules. First, a rule, if well designed and implemented, can provide the transparency and predictability to fiscal policy that helps other participants anticipate the national stance of fiscal policy. Second, a well designed rule, to the extent it helps achieve close to balance or surplus, will presumably help each country to be in a better position to use fiscal policy to smooth output fluctuations in the event of asymmetric shocks. But which rule should a country follow? Kopits and Symansky (1998) identify a wide range of rules that fall into one or another not mutually exclusive categories. There are rules targeting one or another budget balance, public sector borrowing, the level of debt, or contingency reserves, and a host of implicit rules. It therefore seems obvious that there is unlikely to be a "one size fits all" operational rule for all members or for all times.

Against this background, a question comes to mind in reading and thinking about the elegant and interesting paper by Buti, et al. The authors demonstrate that there are gains to fiscal-fiscal cooperation in monetary union when one country is hit by an asymmetric shock. But what if the budget rules don't allow for cooperation to achieve a lower deficit than otherwise? To use the example of the paper—a negative supply shock in a country 1 leads to a fiscal expansion there and, as a response to monetary tightening, to an expansion in country 2 as well. The paper shows that smaller deficits can be achieved through coordination. My question is: suppose country 2 has a strict rule of only allowing the automatic

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stabilizers to work fully, together with firm rules prohibiting offsetting discretionary spending cuts or tax increases. This suggests that, short of finding a "one-size-fits-all" operational fiscal rule, there may be limits to fiscal-fiscal coordination in the presence of some types of tightly enforced national budget rules. One wonders if this would not argue, in turn, for some sort of EU-wide stabilization fund, although this is not in the political cards yet. This may or may not be a rules-related issue, but it has always seemed to me that for fiscal policy in a monetary union to play a stabilization role, some centralized mechanism would be necessary, or certainly helpful.

I am not sure if this notion was implicit or not in the call in the Mills and Quinet paper for more active co-ordination in Europe. But their review of the problems surrounding the calculation and use of the cyclically-adjusted budget balance led them to some useful guidelines for fiscal policy and fiscal rules. They rightly point out, and illustrate vividly in their paper, that estimation of the output gap is indeed subject to quite some uncertainty, which in turn affects estimates of the impact of the cycle on the budget. They also rightly stress that the variability of the "true" elasticities over the cycle can be large, further weakening the confidence one can have in estimates of the cyclically-adjusted budget balance.

Dealing with the uncertainties surrounding estimates of the cyclically-adjusted, or structural, budget balance is increasingly important. First, structural changes in economies are affecting rates of potential output growth, thereby affecting estimates of the output gap and judgments about the fiscal stance. Second, structural changes affecting public revenues and spending are affecting underlying elasticities. It is for this reason that any one measure of the stance needs to be accompanied by complementary measures, such as:

(i) the IMF's fiscal impulse, as proposed by the authors;

(ii) the so-called arbitrary benchmark proposed by Blanchard (1990); and

(iii) a bottom up approach consisting of adding up the effects on the budget of discretionary measures.

One question is touched on but not really addressed in the papers. This relates to the merits, or lack thereof, of using predictably cautious budgetary projections as a feature of a budgetary rule. Many governments prepare budgets using relatively cautious growth assumptions (e.g., the United Kingdom, the Netherlands, Canada and Ireland). This has the obvious advantage of avoiding downside risks of a weaker budgetary outturn. There are some possible disadvantages, however. First, if the degree of caution used in budget preparation (in other words, the extent to which growth is scaled down for budgetary projection purposes) *is not* systematic or known to market participants, this adds uncertainty to economic agents' decision-making process. This would not seem to be a desirable feature of a fiscal policy rule. But second, if the degree of caution *is* systematic and publicized, as it is in some countries, won't the private sector systematically anticipate this and respond accordingly, possibly offsetting the desired impact implied by the stance? It would seem to make more sense to build in caution through budgeting a contingency reserve, as suggested by Mills and Quinet.

Use of cautious growth assumptions points to a potential problem in dealing with windfalls. Often, fiscal over-performance is often treated as structural in nature (i.e., durable), leading decision makers to take discretionary actions that have long-term effects on spending or revenue. If, in the event, the over-performance turns out only to be a windfall, the structural balance could be adversely impacted.

REFERENCES

Blanchard, O.J. (1990), "Suggestions for a New Set of Fiscal Indicators," OECD, Department of Economics and Statistics, Working Paper, No. 79.

Kopits, G. and S. Symansky (1998), "Fiscal Policy Rules", IMF, Occasional Paper No. 162.