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National numerical fiscal rules: Not complied with, but still effective?☆

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ABSTRACT

This paper investigates the effects of (non-)compliance with national numerical fiscal rules on fiscal policy in 11 EU member states with 23 fiscal rules in place from 1994 to 2012. Introducing a new dataset of legal texts constituting the fiscal rules, allows a joint empirical analysis of different types and designs of numerical fiscal rules. In various empirical exercises the change in the difference between the exact variable constrained by the fiscal rule and its numerical limit is analysed. Statistics show that countries comply with their fiscal rules only in about 50% of the years. Nevertheless, various econometric exercises demonstrate that the introduction of fiscal rules does significantly change the behaviour of fiscal policy. If countries do not comply with their fiscal rule in the year or forecast before, there is a strong downward tendency of the constrained variable towards the numerical limit. The results show that fiscal rules act as kind of a benchmark for policy makers and the public, and even though they might be complied with only in half of the years, they still tilt fiscal policy towards the numerical limit in times of non-compliance.

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1. Introduction

In the aftermath of the financial crisis of 2007/2008 the EU (and in particular the Eurozone) slithered into a sovereign debt crisis, caused by high public deficits and uncertainty on the financial markets. As a consequence, several initiatives have been brought forward to strengthen the EU's fiscal governance and regain trust into the sustainability of public finances. Most notably the so-called "six-pack",[2] "fiscal compact"[3] and "two-pack"[4] regulations amended and aligned fiscal governance at supranational and national level. Due to these regulations EU member countries have to introduce fiscal rules, independent fiscal councils and more stringent medium-

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[2] The "six-pack" entered into force in December 2011 and consists of five regulations and one directive of the European Commission and Parliament, introducing stronger macroeconomic surveillance and a reform of the Stability and Growth Pact.

[3] The inter-governmental Treaty on Stability, Coordination and Governance (TSCG or "fiscal compact") entered into force in January 2013 and introduced or strengthened numerical fiscal rules and independent monitoring institutions at the national level.

[4] The "two-pack" consists of two regulations adding monitoring and surveillance procedures to the "six-pack" and stipulating some of the regulations in the "fiscal compact" into EU law.

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term budgeting frameworks in statutory legislation and constitutional laws. The aim of these new regulations is to counteract the deficit bias of governments,[5] lead to balanced public finances and to assure the financial markets about the medium term fiscal goals. Numerical fiscal rules, as part of this strengthened fiscal governance frameworks, have been one of the most important components of the EU's response to the sovereign debt crisis.

This paper is the first to look at (non-)compliance with such national numerical fiscal rules and subsequent changes in fiscal policy. The results show that, contrary to some popular opinion, the actual non-compliance of many countries with their fiscal rules does not necessarily mean that they are not effective. Introducing national numerical fiscal rules does have a strong impact on the behaviour of policy makers, even if the rules are often not complied with. Fiscal rules act as kind of a benchmark for policy makers and the public and, together with the strengthened monitoring, auditing and media awareness, lead to stronger policy reactions to deteriorating public finances.

As more and more data on national fiscal rules has become available,[6] several studies have been published, which analyse the general impact of the existence of fiscal rules on fiscal policy variables, like budget balance or debt levels.[7] Other studies also investigate the effects of introducing fiscal rules on e.g. interest rates (e.g. Iara and Wolff, 2014), cyclicality of output (e.g. Fatás and Mihov, 2006), or in combination with budgetary transparency (e.g. Blume and Voigt, 2013). Most of these studies find a positive effect, i.e. more or stricter fiscal rules improve e.g. the public balances or decrease sovereign risk premiums. Yet these existing empirical studies analyse the binary impact of the existence (combined with some key characteristics) of various types of numerical fiscal rules.[8] The most recent ones (e.g. Debrun, 2008 or Ayuso-i-Casals, 2007) rely on the databases by the European Commission (2010) or the IMF (2012) and use composite indices to describe the national fiscal frameworks. They neglect their details of design, actual level of the imposed constraints and periods of compliance or non-compliance with the rules.

Nevertheless, there are substantial differences in the formulations of national numerical fiscal rules, as can be seen in the following three compressed examples of such rules as defined in national legislation:

Expenditure Rule in Bulgaria (in force since 2012):

> *"The maximum amount of the expenditures in the consolidated fiscal programme may not exceed 40% of forecast GDP."*

Law on the State Budget, Chapter 1, Article 12A

Balanced Budget Rule in Germany (in force from 1969 to 2010):

> *"…Revenue obtained by borrowing shall not exceed the total of investment expenditures…"*

Article 115 (1), Basic Law for the Federal Republic of Germany, after 20th Amendment, May 12, 1969

Expenditure Rule in Lithuania (in force since 2008):

> *".... where the average of the budget balance[…] for the past five […] years […] is a deficit […], the annual growth rate in % of [expenditures] […] for the corresponding year[…] may not exceed one half of the average annual growth rate in % of […] revenues […] for the past five […] years."*

Article 3, Law on Fiscal Discipline, Nov. 2007

All three rules differ in many aspects and additionally the full legal articles usually also include several exceptions and cumbersome instructions on how to calculate the constrained variables. Some countries have rules which are very strict and others have rules which are very loose such that they are always complied with (e.g. the debt rule in Bulgaria). Some rules account for the current economic situation in the design of the numerical constraint, others do not. Previous studies were not able to take this into account, but classified the various fiscal rules according to important characteristics.

The present paper analyses the compliance of countries with different national fiscal rules and its effect, which has not been done in the literature so far. To fill this gap a new dataset is introduced which entails 49 national numerical fiscal rules (mentioned in European Commission, 2010 or IMF, 2012) in the EU27 from 1994 to 2012, which are or were enacted in statutory legislation or constitutional laws and cover the central or general government. Based on this dataset the actual and forecast values of the variables constrained by the respective fiscal rules as well as the numerical limit, both chosen or calculated as stated in the legal documents, were calculated. This allows a joint analysis with different types and different implementations of fiscal rules on the national level.

[5] See e.g. Calmfors and Wren-Lewis (2011) for an overview of the political economy literature regarding the deficit bias of governments.

[6] For a discussion of the historic development of fiscal frameworks see e.g. Schaechter et al. (2012).

[7] For the US, Poterba (1994), Alt and Lowry (1994), Roubini and Sachs (1989) find that more stringent fiscal rules are associated with a higher speed of reduction of unexpected deficits. With regard to the goal of achieving a lower overall budget deficit, there is supporting evidence for the US by Bohn and Inman (1996), Canova and Pappa (2006) and Alesina and Bayoumi (1996); for Canada by Imbeau and Tellier (2004); for Latin America by Alesina et al. (1999); for Switzerland by Feld and Kirchgässner (2006) and Krogstrup and Wälti (2008); for OECD countries by Perotti and Kontopoulos (2002), Dahan and Strawczynski (2010), and Guichard et al. (2007); for EU countries by Hallerberg and von Hagen (1999), Von Hagen and Harden (1994), De Haan et al. (1999), Deroose et al. (2006), Fabrizio and Mody (2006), Ayuso-i-Casals et al. (2007) and Debrun et al. (2008).

[8] Studies using different approaches, without composite indices or binary indicators, to analyse the effect of fiscal rules are e.g. Grembi et al. (2011) employing a difference-in-discontinuities approach with Italian municipalities or Tapsoba (2012) relying on propensity score matching and control function regressions.

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