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Discussion of:

UK reflections on the golden rule (A. King)
Growth, investment and the golden rule (F. Saraceno)

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Strategies to foster fiscal discipline and growth
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1. the golden rule: definition and purpose

Definition:

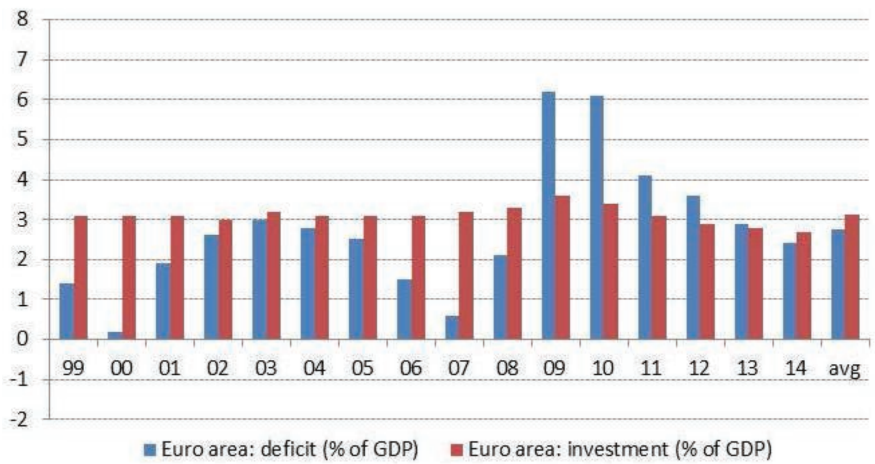
1. borrow only to invest over the economic cycle (*King, Saraceno*)
2. selected expenditure items excluded from SGP deficit figures (*Saraceno*)

Purpose:

1. remove bias against capital spending (*King - Saraceno*)
2. fairness between generations (*King - Saraceno*)
3. foster economic growth (*Saraceno*)

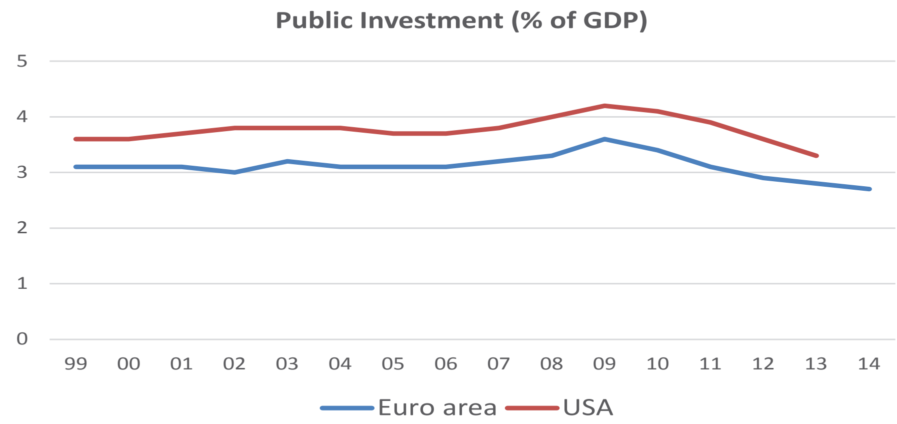
2. A de facto golden rule in the euro area

- ✓ 1999-2014: on average, deficit 2.7% of GDP, investment 3.2%
- ✓ 1999-2007: investment > deficit (3.1 vs 1.8)
  2008-2014: investment < deficit (3.1 vs 3.9)
- ✓ We have been “borrowing only to invest over the cycle”



2. A de facto golden rule in the euro area

- ✓ Similar dynamics in the EA and the USA



3. The bias against investment (I)

1. Long term decline in I/Y has several causes

- ✓ infrastructure needs in advanced countries are no longer the same as in the 1970s
- ✓ in some countries what was once public investment is now private (railways, telecom, energy ...)
- ✓ "innovations" in accounting (PPPs)
- ✓ when measured as a share of primary expenditure the decline in investment is enhanced by the (demography-led) rise in pensions and health-care spending

3. The bias against investment (II)

2. During episodes of fiscal consolidation investment is often "the adjustment variable" (lower resistance)

- ✓ 1992-1997 deficit and investment decline in all countries where the deficit exceeded 3% of GDP in 1992

Deficit and Investment in EU Countries

	Deficit (% of GDP)		Investment (% of GDP)		Investment (% of primary outlays)	
	1992	*1997*	*1992*	*1997*	*1992*	*1997*
Italy	9.6	2.7	3.0	2.4	6.8	5.7
France	3.9	3.0	3.5	3.1	6.9	6.1
Germany	2.6	2.7	2.8	1.9	6.1	4.3
UK	6.2	1.9	2.1	1.1	5.2	3.0
Spain	3.8	2.6	4.1	3.1	9.7	7.9
Belgium	6.9	2.1	1.5	1.4	3.4	3.2
Denmark	2.1	−0.7	1.7	1.8	3.2	3.4
Greece	12.8	4.0	3.5	3.3	10.1	10.2
Ireland	2.5	−0.9	2.0	2.2	5.9	7.1
Luxemburg	−0.8	−1.7	5.4	4.9	n.a.	n.a.
Netherlands	3.9	1.4	2.1	1.9	4.2	4.2
Portugal	3.0	2.5	3.8	4.3	10.7	10.9
Austria	2.0	2.5	3.3	2.6	6.9	5.3
Finland	5.9	0.9	3.5	2.7	6.0	5.5
Sweden	7.7	0.8	2.7	2.4	4.3	4.2

Source: Balassone and Franco, 2000

3. The bias against investment (III)

3. On average, investment-to-GDP is stable in the EA and the EU before and during the crisis (while the deficit increases)

Public Investment (%GDP)

	1999-2007	2008-2014
Austria	2,6	3,1
France	3,9	4,0
Germany	2,1	2,2
Italy	2,9	2,8
euro area	**3,1**	**3,1**
UK	2,1	2,9
EU	**3,0**	**3,2**

3. The bias against investment (IV)

✓ the bias does not come from fiscal rules per se, it comes from fiscal consolidation

✓ if fiscal consolidation is necessary, then

- the solution cannot be a change in the rules (UK: “while keeping debt at a prudent level”)
- how to consolidate is a political choice (economics can provide guidance: is cutting transfers/services less contractionary than cutting investment?)

✓ if fiscal rules “force” unnecessary consolidation, then they should be amended (with the activation of the margins of flexibility allowed under the SGP we are going in the right direction)

3. The bias against investment (V)

- ✓ the debate seems to be about “allowing larger deficits” (“EU priorities – not necessarily physical capital – can be excluded from SGP deficit figures”, *Saraceno*)
  - how larger? The golden rule should apply to net investment (probably about 1/3 of gross fixed capital formation, which can be accommodated within the boundaries of the SGP/FC given the definition of the MTO)
  - under the SGP/FC, debt-to-GDP does not converge to 0
    - max MTO=1% of GDP implying $D/Y \rightarrow 30\%$ ($g=3.5\%$)
    - debt rule: D/Y from 130% to 70% in almost 40 years
- ✓ the question remains of whether deficits are sustainable (and whether the answer to low economic growth – cyclical or secular – can be found in permanently higher government deficits)

4. Intergenerational fairness

- ✓ with a homogeneous expenditure flow, the difference between tax and debt financing is limited
- ✓ it is a bit like a pay-as-you-go pension system:
  - only those generations living when the earliest projects are undertaken benefit from deficit finance
  - later generations will have to pay more or less the same (whether they face interest on past debt while new projects are financed by new debts, or taxes to finance new projects while past ones have already been paid for)
- ✓ the issue resurfaces during fiscal consolidations since reducing the deficit is a bit like reversing a pay-as-you-go pension system
- ✓ the problem, again, is one of sustainability

5. Public investment and economic growth (I)

✓ IMF 2014: “Debt-financed projects could have large output effects without increasing the debt-to-GDP ratio …”

✓ a strong statement considering the dispersion of earlier estimates of the elasticity of GDP to public investment

- USA: 0.04 (Pereira, 2001) - 0.4 (Abdih and Joutz, 2008)
- EU: 0.08 (Cadot *et al*, 2006) - 0.5 (Pereira, Roca-Segales, 2003
- Italy: 0.12 (DeStefanis, Sena, 2005) - 0.6 (Di Giacinto *et al*, 2010)

5. Public investment and economic growth (II)

✓ a statement subject to some qualifications:

- IMF 2014: “this should not be interpreted as a blanket recommendation for a debt-financed public investment increase, as adverse market reactions […] could rise financing costs and increase debt pressure [in high debt countries]”
- IMF 2014: higher investment can be beneficial only “if clearly identified infrastructure needs are met through efficient investment”
- WB 2014: “without efficient management, investment spending is unlikely to be fiscally sustainable and would not promote growth and development”
- IMF 2015: “comparing the value of public capital and measures of infrastructure coverage and quality across countries reveals average inefficiencies […] of around 30%”