EU fiscal rules in times of slow growth; investment rules

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The new and the old

- New: marked slowdown in world economy, especially Emerging Economies. EZ needs to play role boosting own + global growth
- In the past, EE rapid growth, played key role in boosting world aggregate demand
- Old: anemic growth continues Eurozone; limited decline unemployment
- New: Negative political impacts increased,eg risk Brexit, strengthening Eurosceptic parties all EU

Urgency action

- More flexible fiscal policy key, both nationally and EU level, given limits monetary policy
- Specially important, expand investment, including especially public, for stimulating short-term growth, to avoid secular stagnation as well as for structural change to green economy
- Greater flexibility in implementing EZ fiscal rule would be especially valuable
- New IMF research backs effectiveness of fiscal counter-cyclical policy

Investment rule optimizes counter-cyclical impact

- Number of IMF papers, WEO and recent research paper IMF,Guergil et al , 2016 shows empirically, clearly, with large sample, current EZ fiscal rules associated with pro-cyclical bias, especially for investment.
- EU investment has declined from 19.0% of GDP in 2007 to 15.3% in 2014. Fall far larger South EZ, from 22% to 14%. Damaging present and future growth

There is a solution

- Modifications fiscal rules can increase counter-cyclicality; experience since 70s, but increased interest since 2000s.
- IMF research shows clearly most effective change is to introduce investment friendly fiscal rule.(IR) Other changes less clear effects
- IR allows certain categories of investment, eg which increases productivity, excluded from fiscal deficit

Impact IR

- Empirically IMF and other research shows IR increases counter-cyclicality of total fiscal spending and of investment, without weakening fiscal discipline and debt sustainability
- IR empirically clearly better for increasing counter-cyclicality than other flexible rules
- Empirical results significant and robust

Pre-conditions for successful IR

- Need to avoid accounting procedures to re-classify spending as investment
- Make sure public investment efficient, especially for increasing long-term inclusive growth
- May require expanding tax base and improving tax collection, to help reduce future budget pressures

Complementary or alternative policies

- Increased role of national development banks, as well as European Investment Bank, to help catalyze public and private investment
- Opening additional space for counter-cyclical fiscal policies, with instruments such as GDP linked bonds, currently being actively discussed by G-20, Bank of England, Bank of Canada