Fiscal Rules

Most OECD countries have since long adopted fiscal rules to safeguard budget sustainability. Well known is the famous "Golden Rule" (in force e.g. in Germany and UK) which states that net public borrowing in a year must not exceed net public investment of that year. But other – and stricter – rules are also used. In some countries the rules have been only recently adopted or reinforced. The table informs about the various regulations and rules in force in a selection of OECD countries.

For some countries the rules apply to the consolidated government budget. Then the question arises how the different – specifically the lower – levels of government are made to behave in a way which conforms to the general rule. Some country comparative information to this question is provided in DICE Report 1/2004 ("Macroeconomic Management of Decentralised Fiscal Decisions").

An explicit limit for public expenditures is defined in some countries. In Finland, e.g., the cap on expenditures extends over a four years period (actually from 2004 till 2007), but some items are excluded from the cap. In Sweden, limits are defined for 27 different expenditure items. Additionally, a two percent budget surplus must be realised over the business cycle.

Some countries observe rules which put an indirect ceiling on public expenditures. In Denmark, e.g., this is realised by a combination of a tax freeze – binding for all levels of government – and the rule of a structurally (i.e., cyclically adjusted) balanced budget.

In this context, also the rules of the Maastricht Treaty (1992, extended in 1997) are of relevance which apply to the EU countries: General government net borrowing is limited to 3 percent of GDP; over the cycle the budget must be close to balance or in surplus; and the government's gross debt must conform to the norm of not exceeding 60 per-

Fiscal rules in selected OECD countries

Country/ region	Year of implementation	Summary
Austria	2000	Domestic Stability Pact Law • Negotiated floors on the budget balance for each government level (a surplus of 0.74 percent of GDP for the *Länder*, zero for municipalities and the federal government balance should be such that the Stability Programme target is met). Outcomes are assessed by an independent auditor. The law embodies financial sanctions in case of non-compliance.
Belgium	1999	Cooperation agreement • Permissible deficits are established for the federal government plus Social Security on the one hand, and for the regions and the local government on the other.
Denmark	2001	A medium-term fiscal strategy for the period until 2010 • Structural general government surpluses of around 2 percent of GDP. • A "tax freeze" covering both central and subnational government (introduced in 2002).
Finland	2004	Medium-term objectives • Balanced central government finances in structural terms by 2007. • Central government expenditure (excluding interest payments, unemployment benefits and a few other items) is subject to a cap over the period 2004 to 2007.
Germany	2002	Domestic Stability Pact • Golden rule: the budgeted deficit of the federal government must not exceed federal investment spending. Most *Länder* constitutions have a similar law. • Both the central government and subnational governments should aim at balanced budgets.
Netherlands	1994	Multi-year expenditure agreements • Separate expenditure ceilings on central government, social security, and labour market and health spending. • Automatic stabilisers are allowed to work fully on the revenue side, except if the deficit came close to the Maastricht Treaty's 3 percent ceiling.
Spain	2003	Fiscal Stability Law • Accounts should balance or show a surplus at all levels of government (central, social, territorial and local) as well as for public enterprises and corporations. • A cap is put on central government expenditure and a contingency fund (2 percent of expenditure) is set up to cover unscheduled non discretionary expenditure.
Sweden	1997	Fiscal Budget Act • Set nominal expenditure limits for the subsequent three years on 27expenditure areas (including social security). • Maintain a general government surplus of 2 percent of GDP on average over the business cycle.

continued: Table

United Kingdom	1997	Code for Fiscal Stability • Golden rule: over the business cycle, the Government will borrow only to invest and not to fund current spending. • Sustainable investment rule: net debt as a proportion for GDP must be held stable over the business cycle at a prudent level (defined so far as net debt below 40 percent of GDP).
EU area/ EU countries	1992	Maastricht Treaty; extended in 1997 under the Stability and Growth Pact • 3 percent of GDP ceiling on general government net borrowing. • "Close to balance or surplus" target applying in cyclically-adjusted term each year. • 60 percent of gross government debt-to-GDP ratio norm.
Norway	2001	Fiscal Stability Guidelines • Structural non-oil central-government budget deficit should not exceed 4 percent of the Government Petroleum Fund over the cycle. • In the event of major revaluations of the Fund's capital or statistical revisions of the structural deficit, corrective action should be spread over several years.
Switzerland	2003	Debt Containment Rule • Sets a ceiling for expenditures which is equal to total revenues adjusted for the cycle and for ex post deviations of out-turns from the norm laid out in the rule.
Poland	1999	Act on Public Finance • The Constitution sets a limit of 60 percent of GDP for total public debt.
Australia	1998	Charter of Budget Honesty • No legislated numerical rules. The Charter requires the government to spell out objectives and targets but places no constraints on their nature.
Canada	1998	Debt Repayment Plan • There are no legislated rules at the federal level but the government has a "balanced budget or better" policy. Most provinces have some form of balanced budget legislation.
Japan	2002	A Reform and Perspective programme (revised in 2003) • Maintain general government expenditures at or below the 2002 level of 38 percent of GDP. • Achieve primary budget surplus by early 2010s.
New Zealand	1994	Fiscal Responsibility Act • Maintain debt and net worth at "prudent" levels and run operating surpluses on average over a "reasonable" period of time. The Government sets its own numerical targets consistent with these principles.
United States	1990 to 2002	Budget Enforcement Act • Medium-term nominal caps for discretionary spending. • Legislated changes to revenues or mandatory spending programmes should be budget neutral over a five-year horizon.

Source: See reference.

cent of GDP. (The EU Commission procedure in case of an "excessive deficit", however, applies only to the Euro countries.)

A budget rule which is applied not in each budget year but (only) over the cycle is basically reasonable from an economic point of view. On the other hand, it opens room for discretionary decisions because what the cycle and its average GDP growth rate is can not be known in advance – but has to be known for determining what size of a budget deficit in a specific year conforms to the cycle. Moreover, to allow for business cycle effects on the tolerated size of the budget deficit will reduce the simplicity of assessing the deficit and will add an element of ambiguity – at least in the public discussion of the budget.

Problems also arise with the "Golden rule". Usually, investment in this context is defined as fixed investment and excludes investment in human capital, although the latter might even earn a higher social rate of return. On the other hand, including human capital investment might provide leeway for discretionary decisions and could invalidate the very intention of the Golden Rule. Moreover, fixed investment should be calculated as a net value, i.e. net of amortisation. But the difficulty is to determine correctly the amount of amortisation. This might again open room for opportunistic behaviour.

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Reference

Joumard, I., P.M. Konksrud, Y.-S. Nam and R. Price (2004), Enhancing the Effectiveness of Public Spending: Experience in OECD Countries, *OECD Economics Department Working Paper* No. 380.