

Enhancing the effectiveness of fiscal rules: the role of compliance and complementary fiscal institutions

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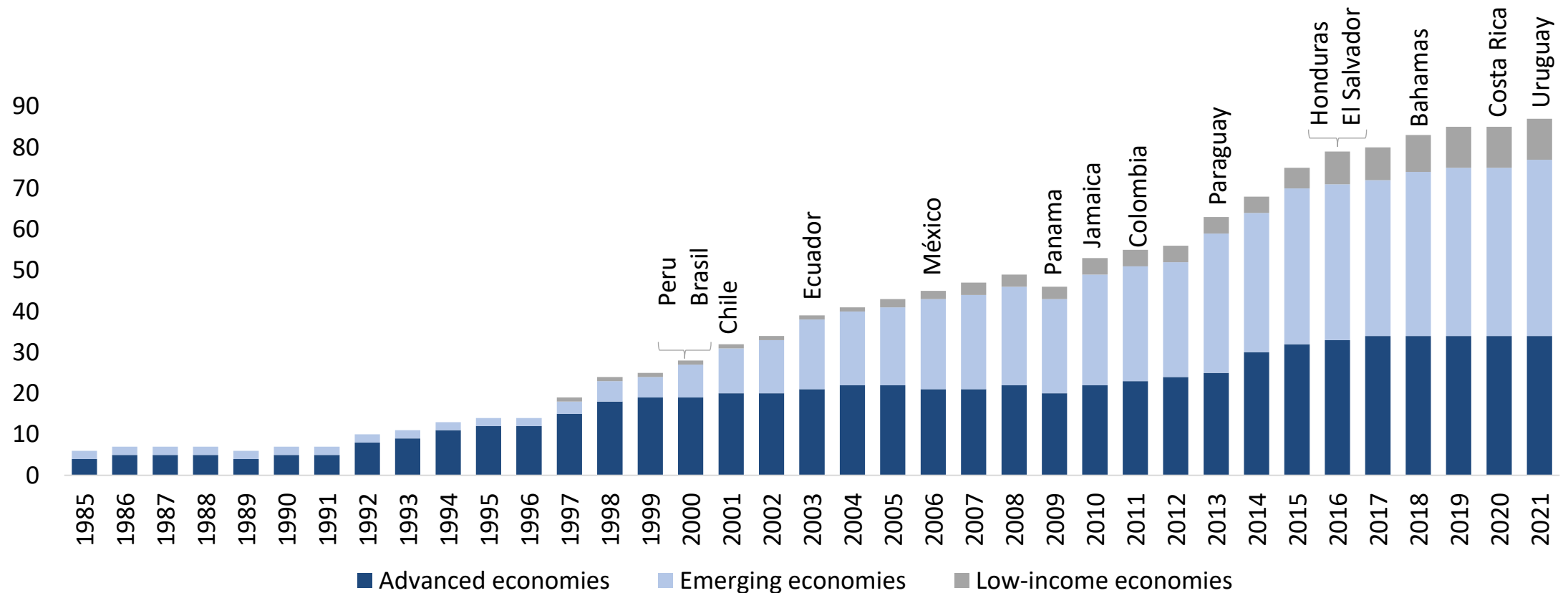


Agenda

- Why Compliance Matters
- Complementary Institutions: Fiscal Councils and Medium-Term Fiscal Frameworks
- Reform opportunities

Fiscal rules have become an increasingly popular policy tool

Number of countries with at least one national fiscal rule



Varieties of fiscal rules in Latin America and the Caribbean

	Type of rule				Year	Coverage	Legal basis	Flexibility features		
	Balance	Expenditure	Debt	Revenue				Escape clause	Structural target	Investment protection (direct/indirect)
Bahamas	✓	✓			2018	CG	S	✓		✓
Brazil	✓	✓			2000/2023	CG	S	✓		
Chile	✓		✓		2001/2022	CG	S		✓	
Colombia	✓		✓		2021	CG	S	✓	✓	
Costa Rica		✓			2018	NFPS	S	✓		✓
Ecuador	✓	✓	✓		2020	CG	S	✓		
El Salvador	✓	✓	✓	✓	2016/18	NFPS	S			
Honduras	✓	✓			2016	NFPS	S	✓		✓
Jamaica	✓		✓		2010/2017	GG	S	✓		
México	✓	✓			2009/2014	CG	S	✓		
Panamá	✓		✓		2009/2020	NFPS	S	✓		
Paraguay	✓	✓			2015	CG	S			
Perú	✓	✓	✓		2000/2016	CG	S	✓		✓
Uruguay	✓	✓			2020	CG	S	✓	✓	

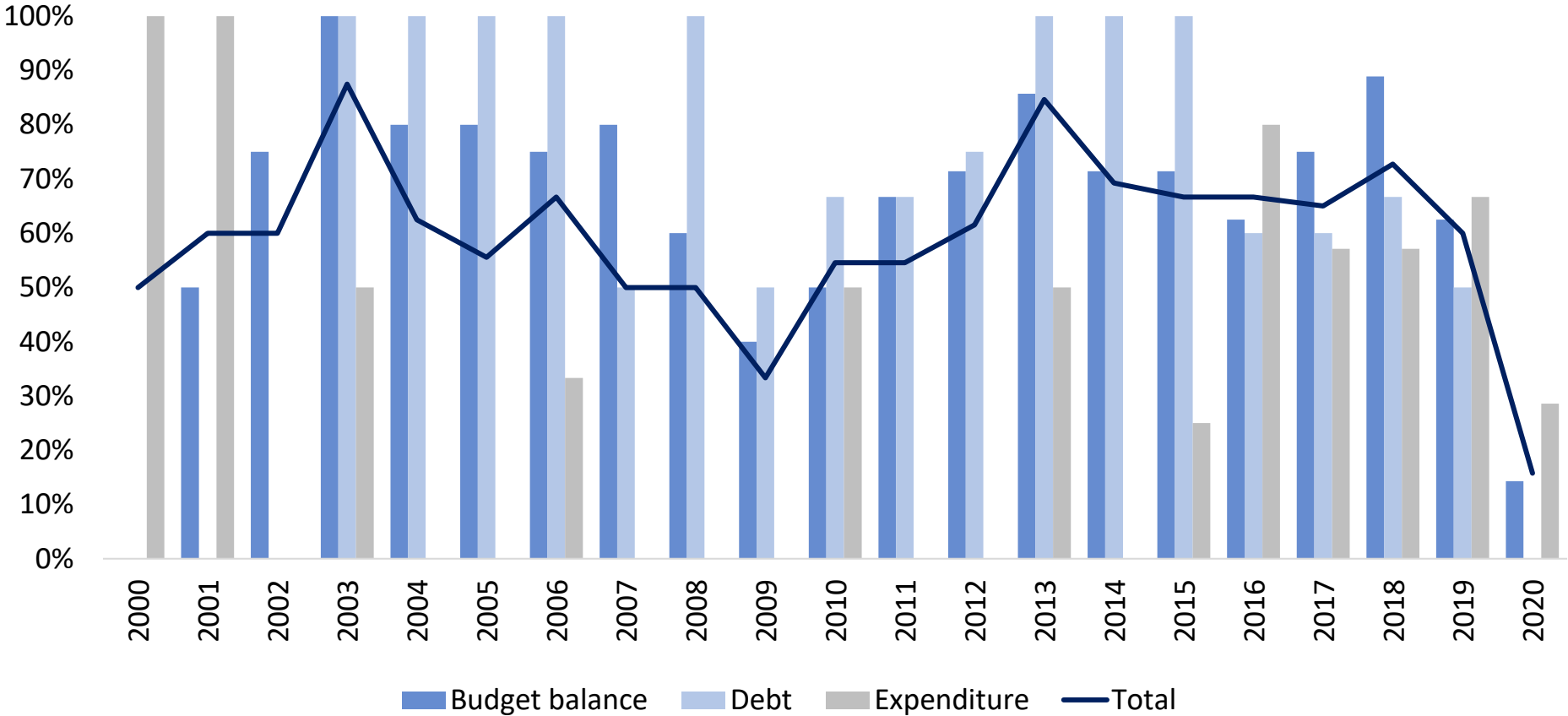
Notes: GG-general government; CG-central government; NFPS-Non-financial public sector; S-statutory.



Compliance: from promises to action

Complying with fiscal rules is not automatic

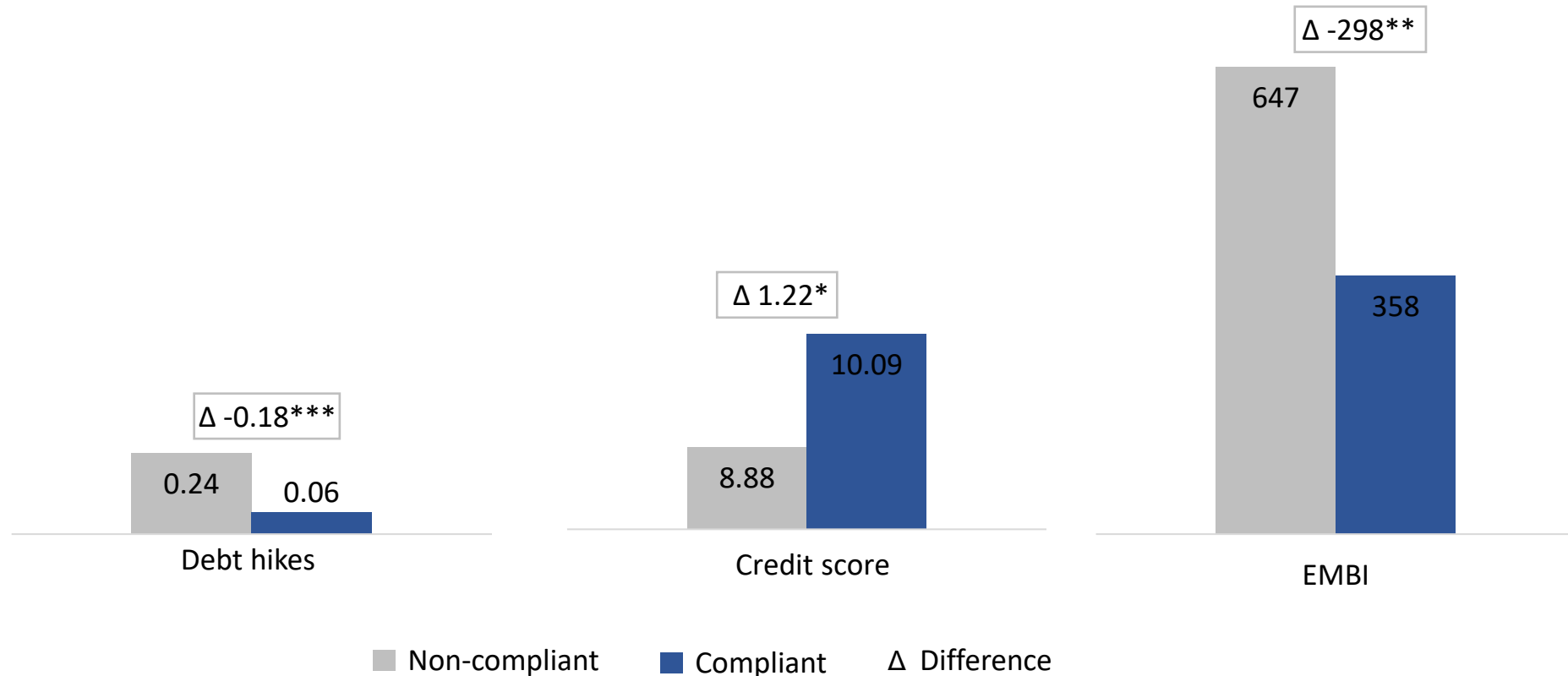
Fiscal rules compliance rates in Latin America and the Caribbean (%)



Source: Ardanaz, Ulloa-Suarez y Valencia (2023)

The benefits of *complying* with fiscal rules...

Rule compliance and fiscal performance



Statistically significant differences : *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Source: Ardanaz, Ulloa-Suárez y Valencia (2023)

...not accrued by merely *adopting* fiscal rules

Rule adoption and fiscal performance



Statistically significant differences : *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Drivers of compliance with fiscal policy rules in LAC

Design elements

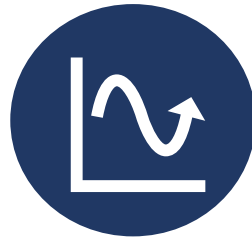


Formal Sanctions



Fiscal Councils

Macroeconomic conditions



Business cycle



Quality of macro-economic forecasts

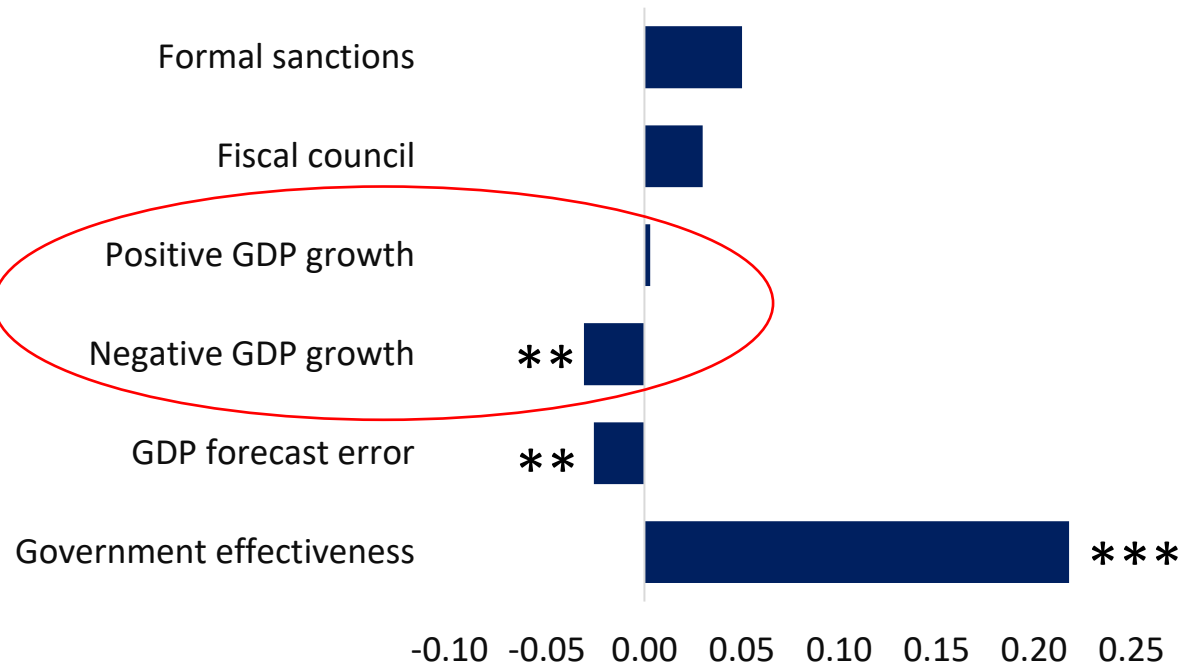
Deeper determinants



Institutional Quality

Drivers of compliance: key results (1)

Probability of compliance



Statistically significant coefficients: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

- Asymmetrical response of compliance to macroeconomic conditions

Macroeconomic conditions and compliance

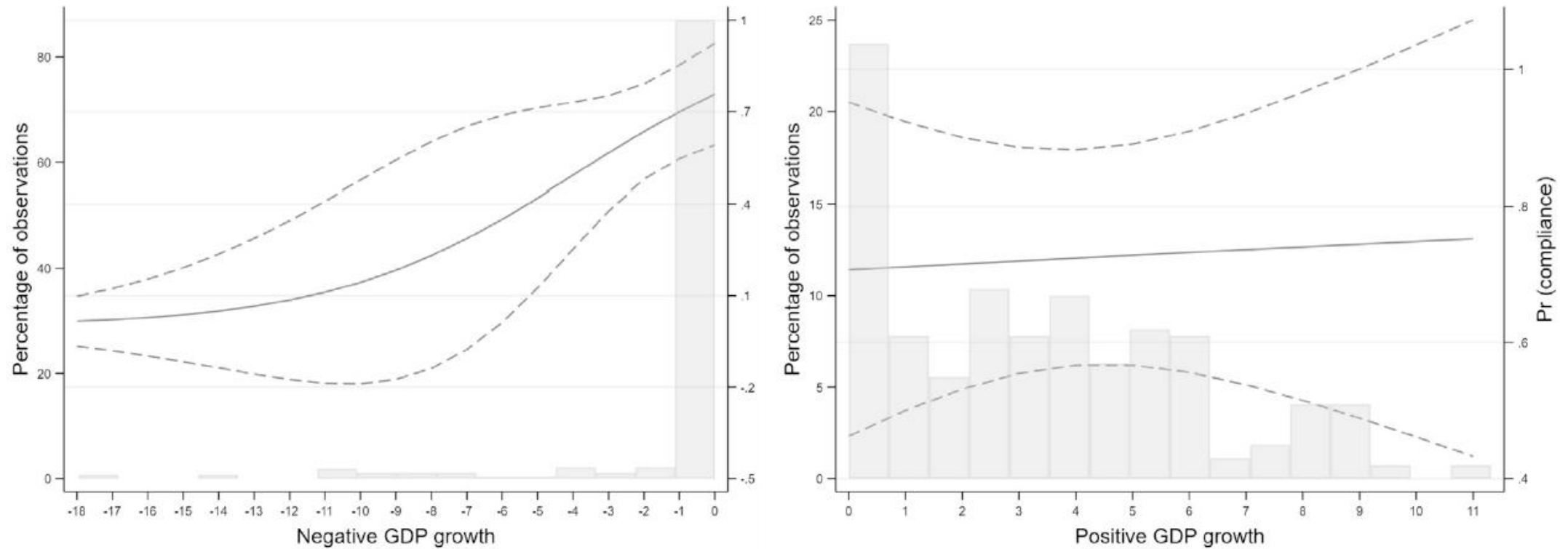
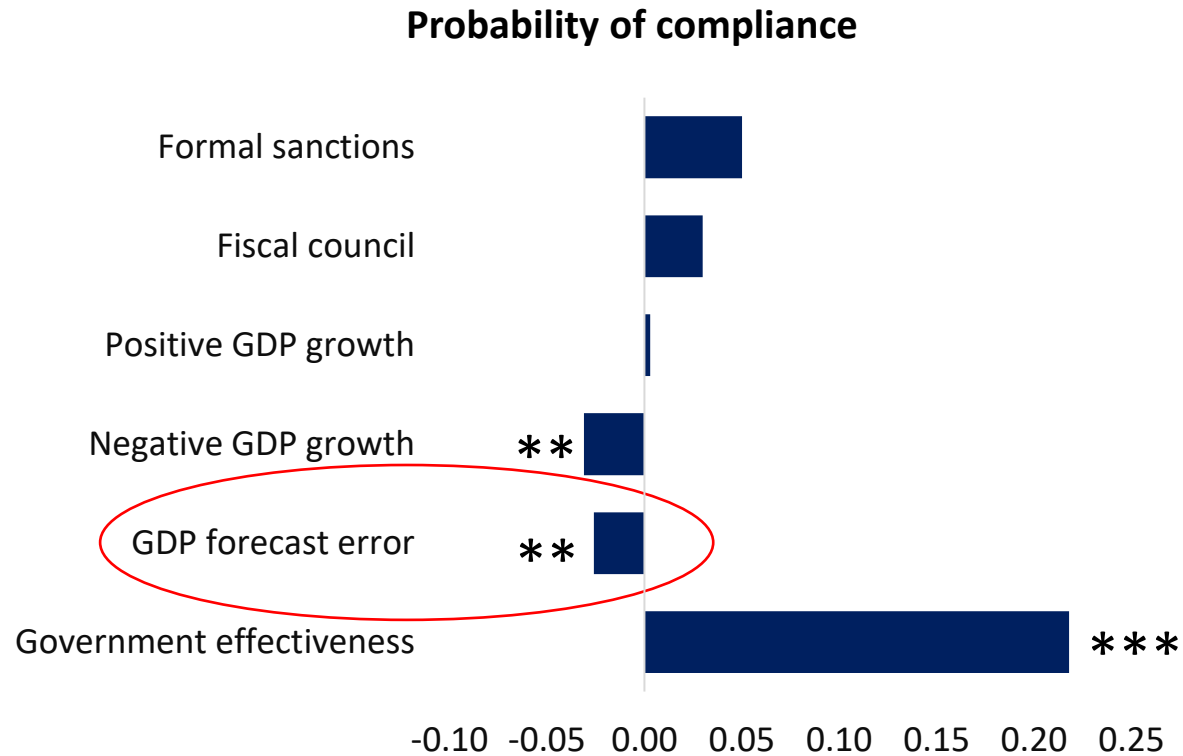


Fig. 2. Probability of compliance and GDP growth rates.

Drivers of compliance: key results (2)



Statistically significant coefficients: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

- Asymmetrical response of compliance to macroeconomic conditions
- Optimistic macroeconomic forecasts undermine compliance during the budget cycle...

Optimistic ex-ante projections and ex-post compliance

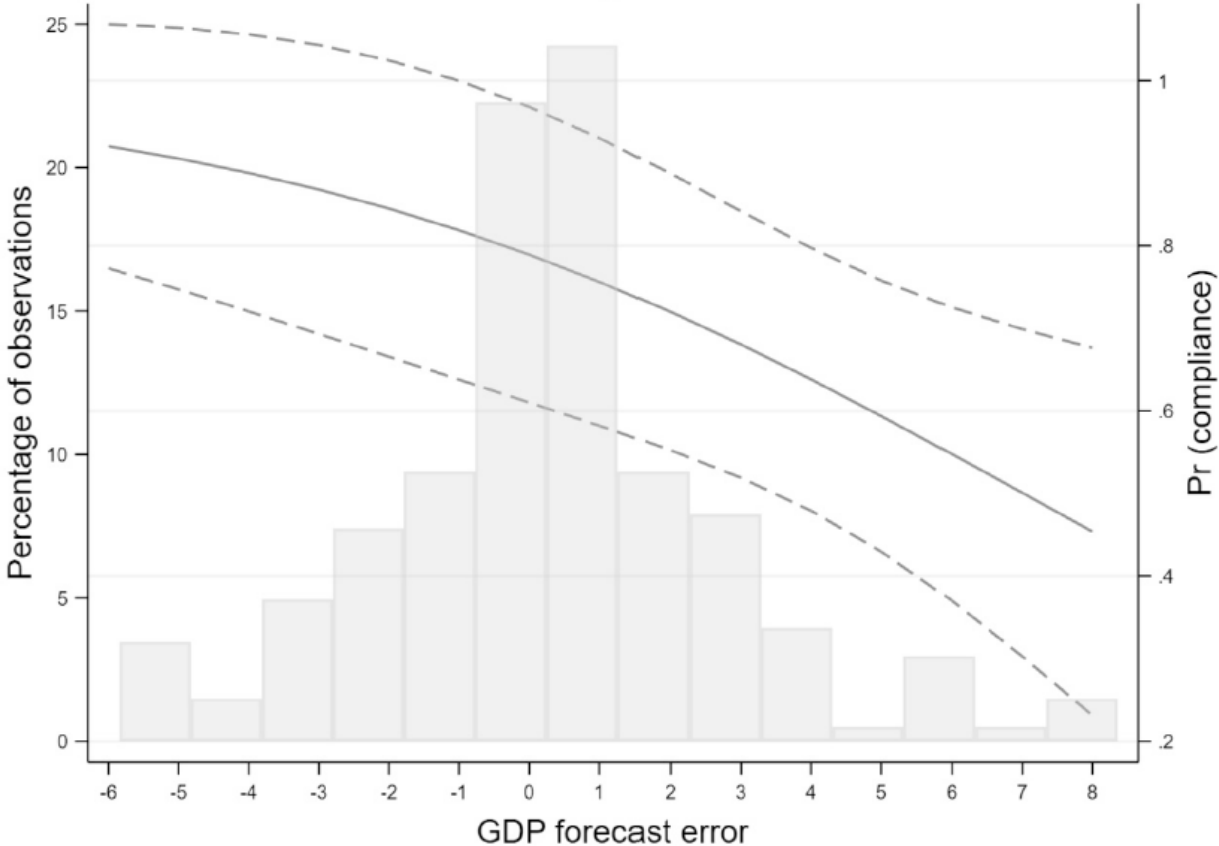
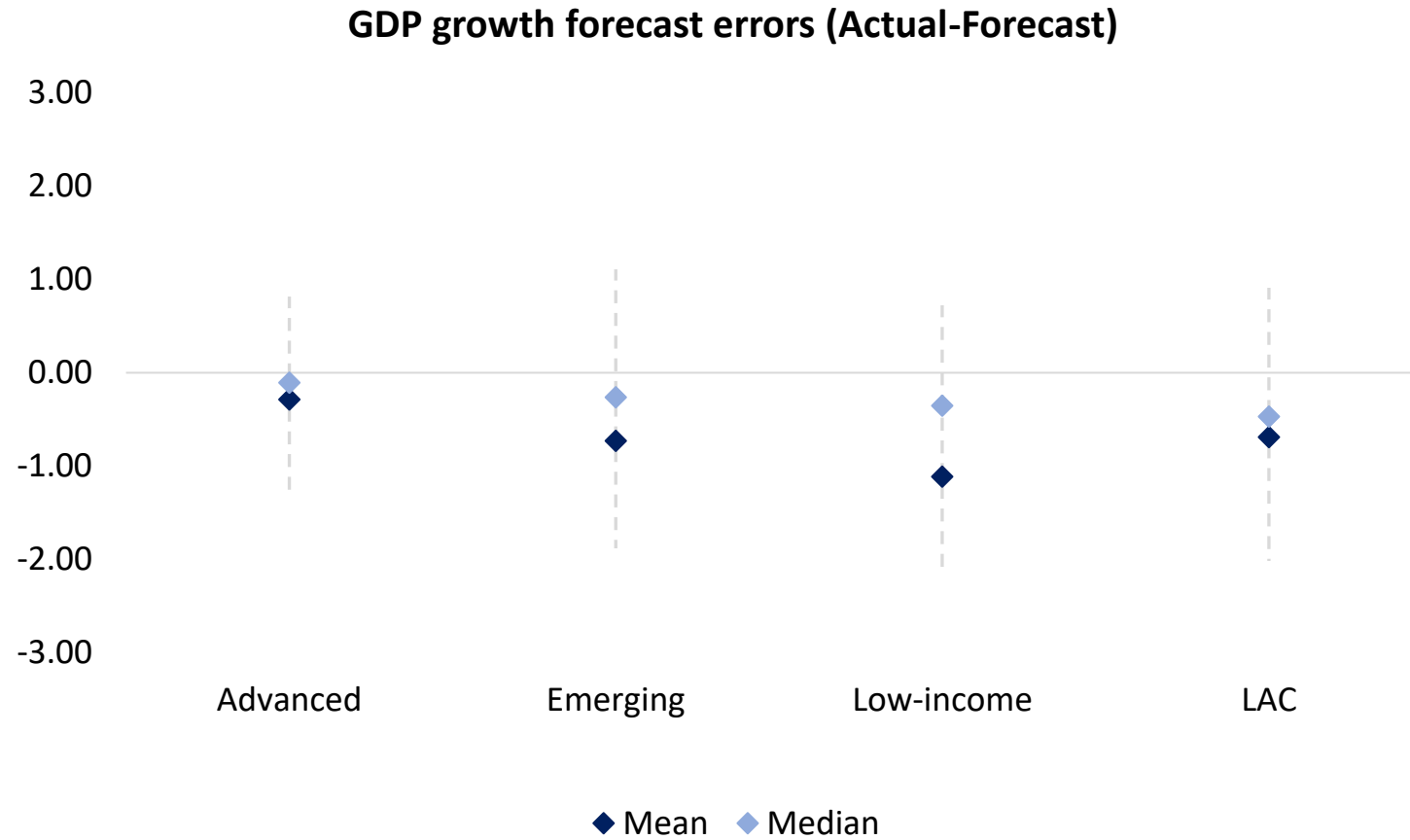


Fig. 4. Probability of compliance and output forecast errors.

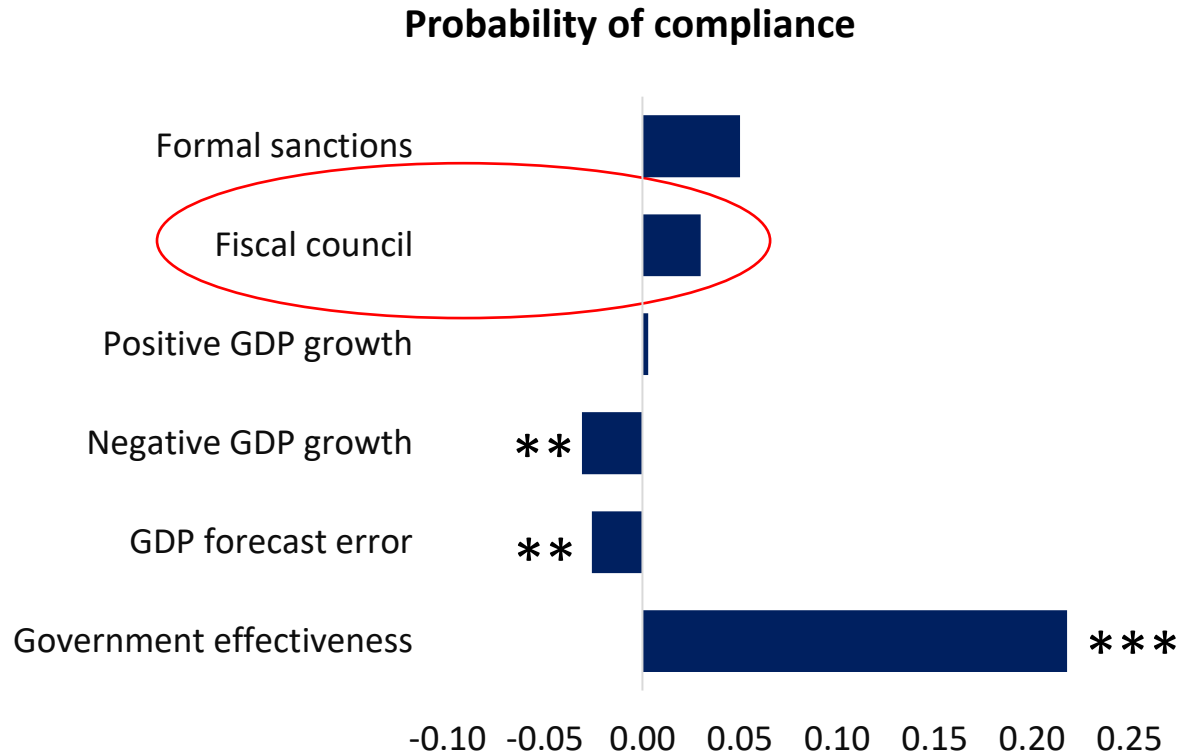


Source: Ardanaz, Ulloa-Suarez and Valencia (2023)

Accuracy of forecasts in comparative perspective



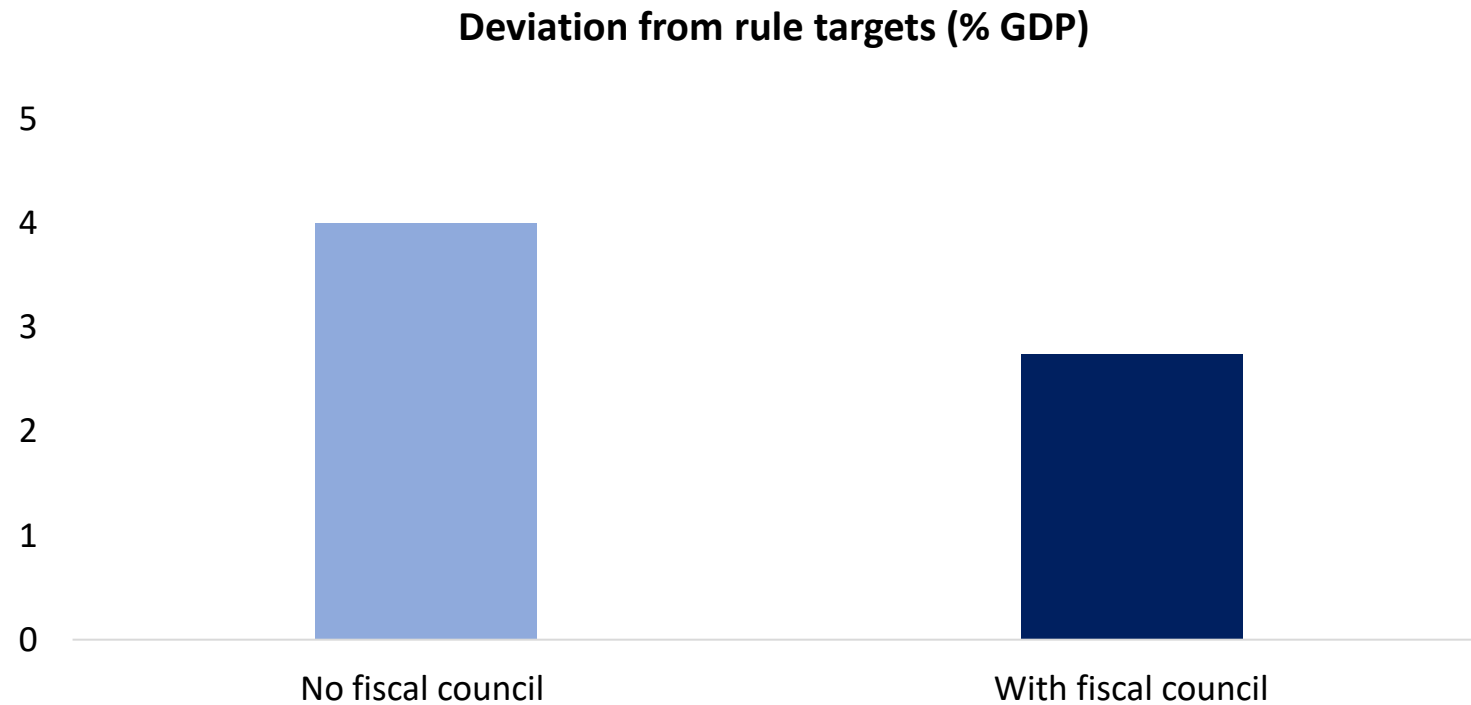
Drivers of compliance: key results (3)



Statistically significant coefficients: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

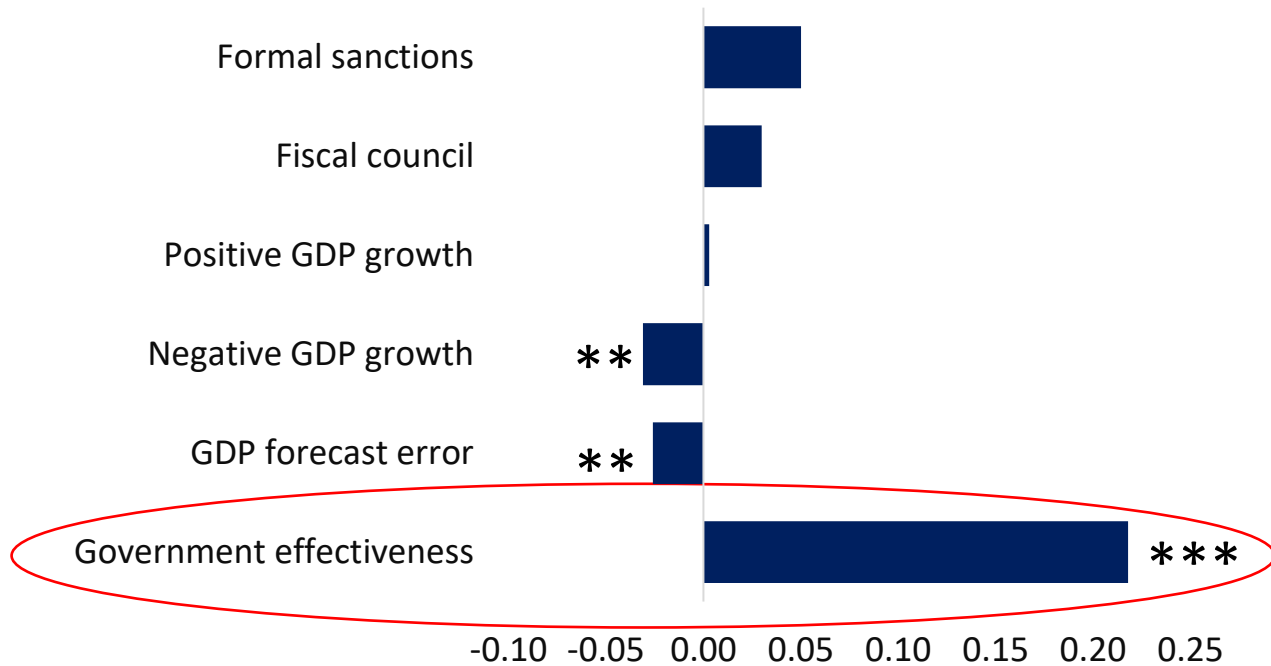
- Asymmetrical response of compliance to macroeconomic conditions
- Optimistic macroeconomic forecasts undermine compliance during the budget cycle
- Presence of fiscal council not enough to boost compliance...

In contrast to experience in OECD countries



Drivers of compliance: key results (4)

Probability of compliance



Statistically significant coefficients: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

- Asymmetrical response of compliance to macroeconomic conditions
- Optimistic macroeconomic forecasts undermine compliance during the budget cycle
- Presence of fiscal council not enough to boost compliance
- Quality of the broader institutional framework (political commitment) matters

Quality of the broader institutional framework and compliance

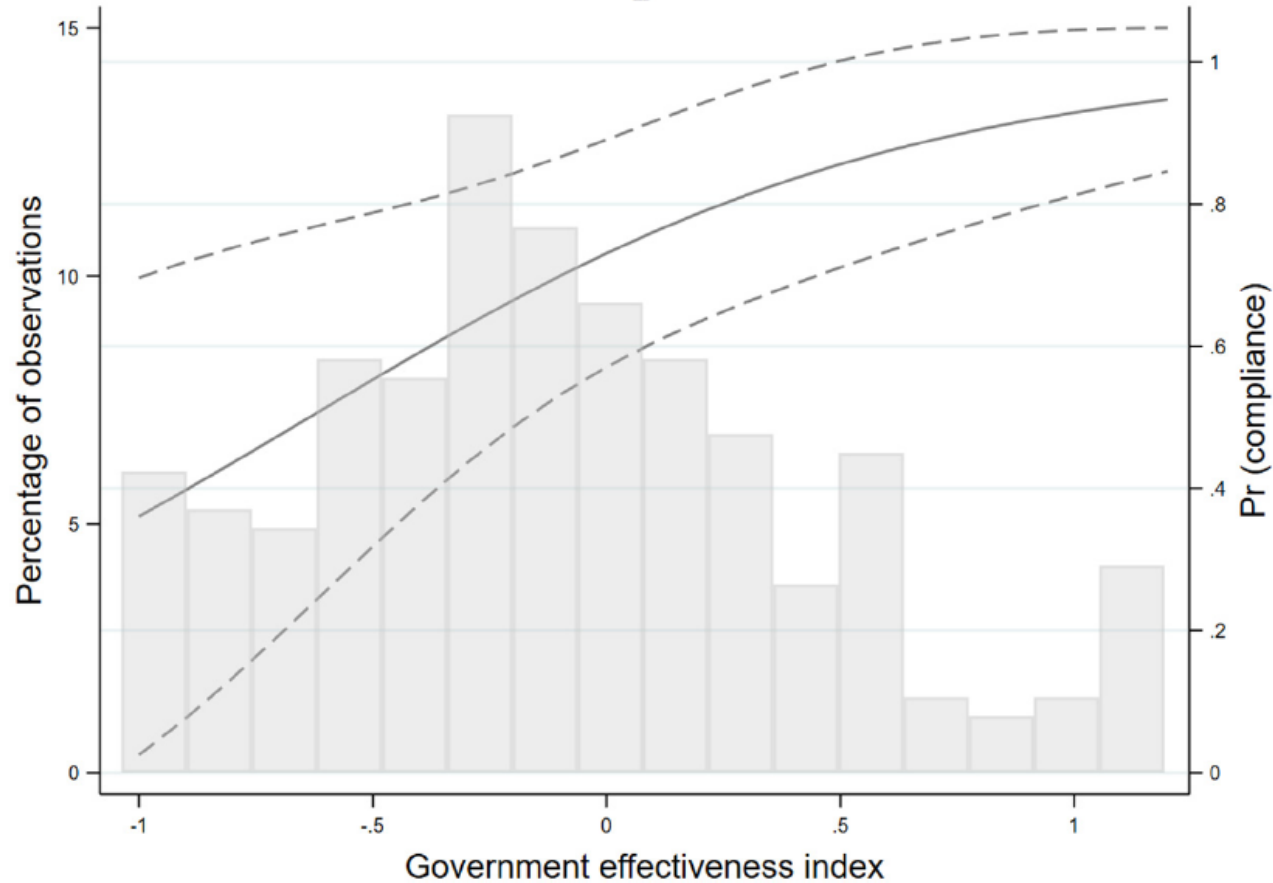


Fig. 5. Probability of compliance and institutional quality.



Complementary fiscal institutions: Fiscal councils and MTFF

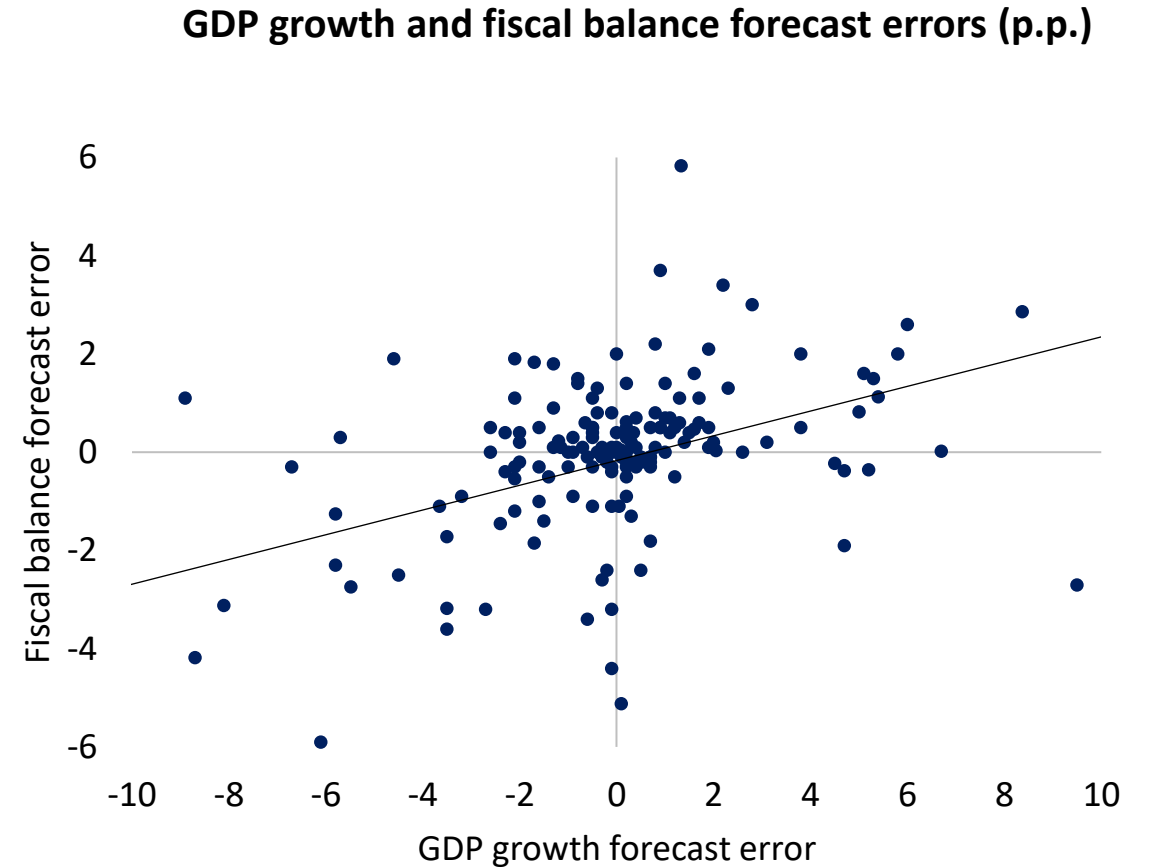
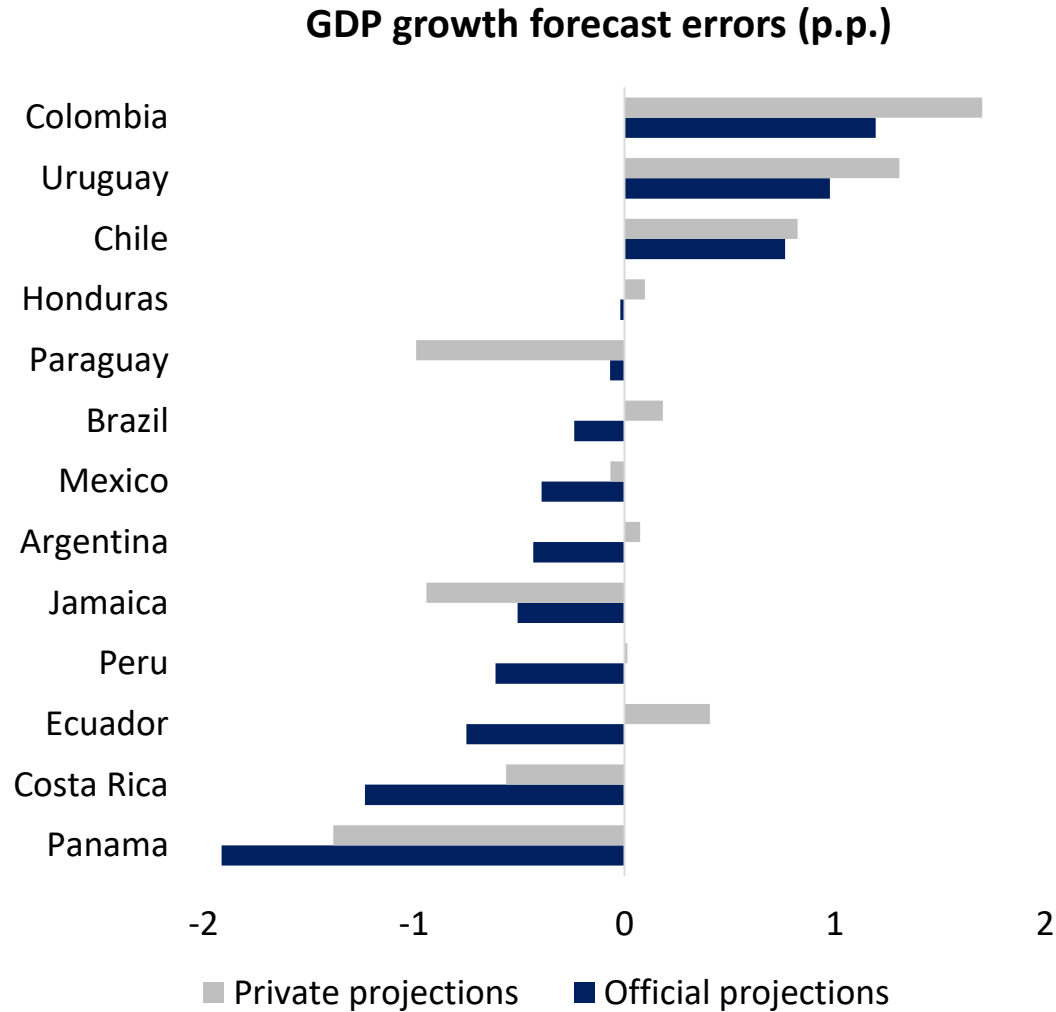
Fiscal councils in Latin America and the Caribbean



Fiscal councils: tasks not always commensurate with resources in LAC

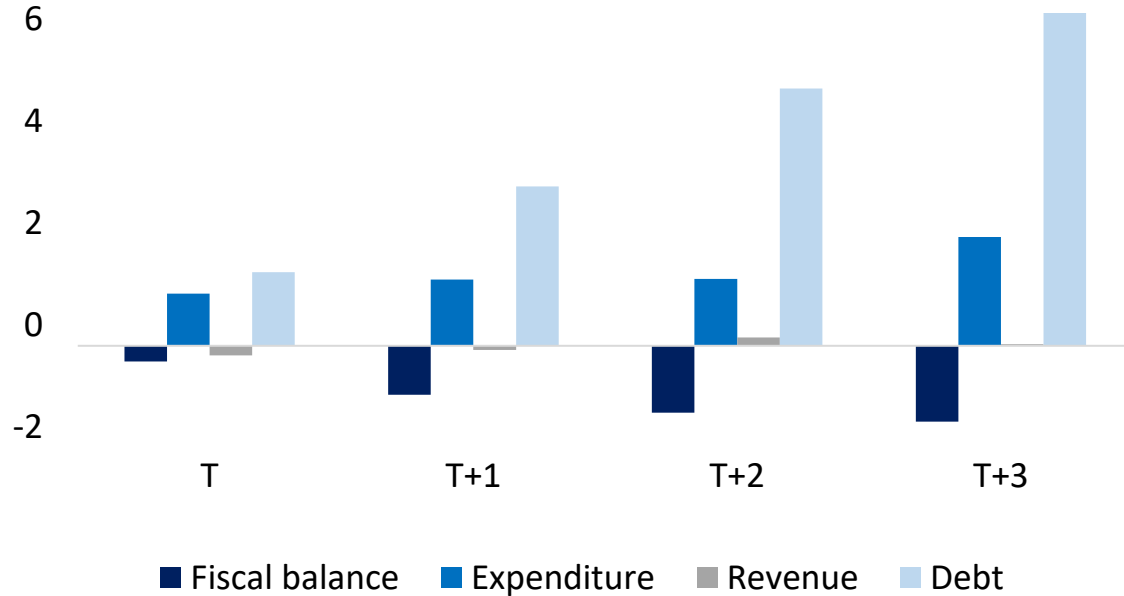
Country	Year	Operational independence	Safeguard on budget	Governing members	Staff	Tasks				
						Fiscal rules monitoring	Forecasts assesment	Performance assesement	Long-term analysis	Policy costing
Australia	2012	✓	✓	7	36			✓	✓	✓
France	2013	✓	✓	11	5	✓	✓	✓		
Korea	2003	✓	✓	1	125		✓	✓	✓	✓
Netherlands	1945	✓	✓	3	122			✓	✓	✓
Portugal	2012	✓	✓	7	18	✓	✓	✓	✓	
Spain	2014			5	31	✓	✓	✓	✓	
Sweden	2007	✓	✓	6	6	✓	✓	✓	✓	
UK	2010	✓	✓	3	34	✓	✓	✓	✓	✓
Bahamas	2019		✓	5	0	✓		✓	✓	
Brazil	2016	✓	✓	3	6	✓	✓	✓	✓	✓
Chile	2019	✓	✓	5	3	✓	✓	✓	✓	
Colombia	2021	-	✓	7	8	✓	✓	✓	✓	
Costa Rica	2021			3	0	✓	✓	✓		
México	1998			5	60		✓			✓
Panamá	2018	-	✓	3	-	✓	✓	✓		✓
Perú	2015	✓	✓	5	8	✓	✓	✓		
Uruguay	2021	✓		3	1	✓	✓	✓	✓	

Space to enhance credibility of forecasts in medium-term fiscal frameworks

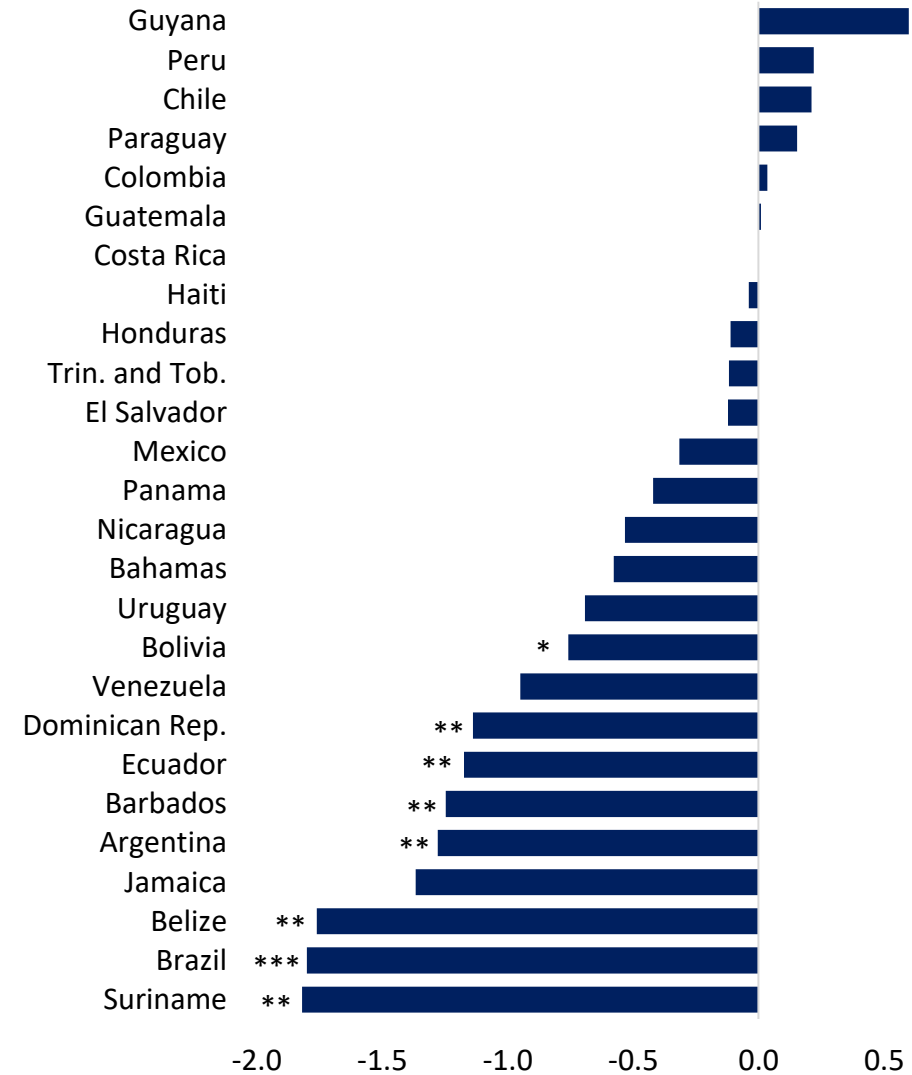


Space to enhance credibility of forecasts in medium-term fiscal frameworks

Fiscal forecast errors (p.p. of GDP)

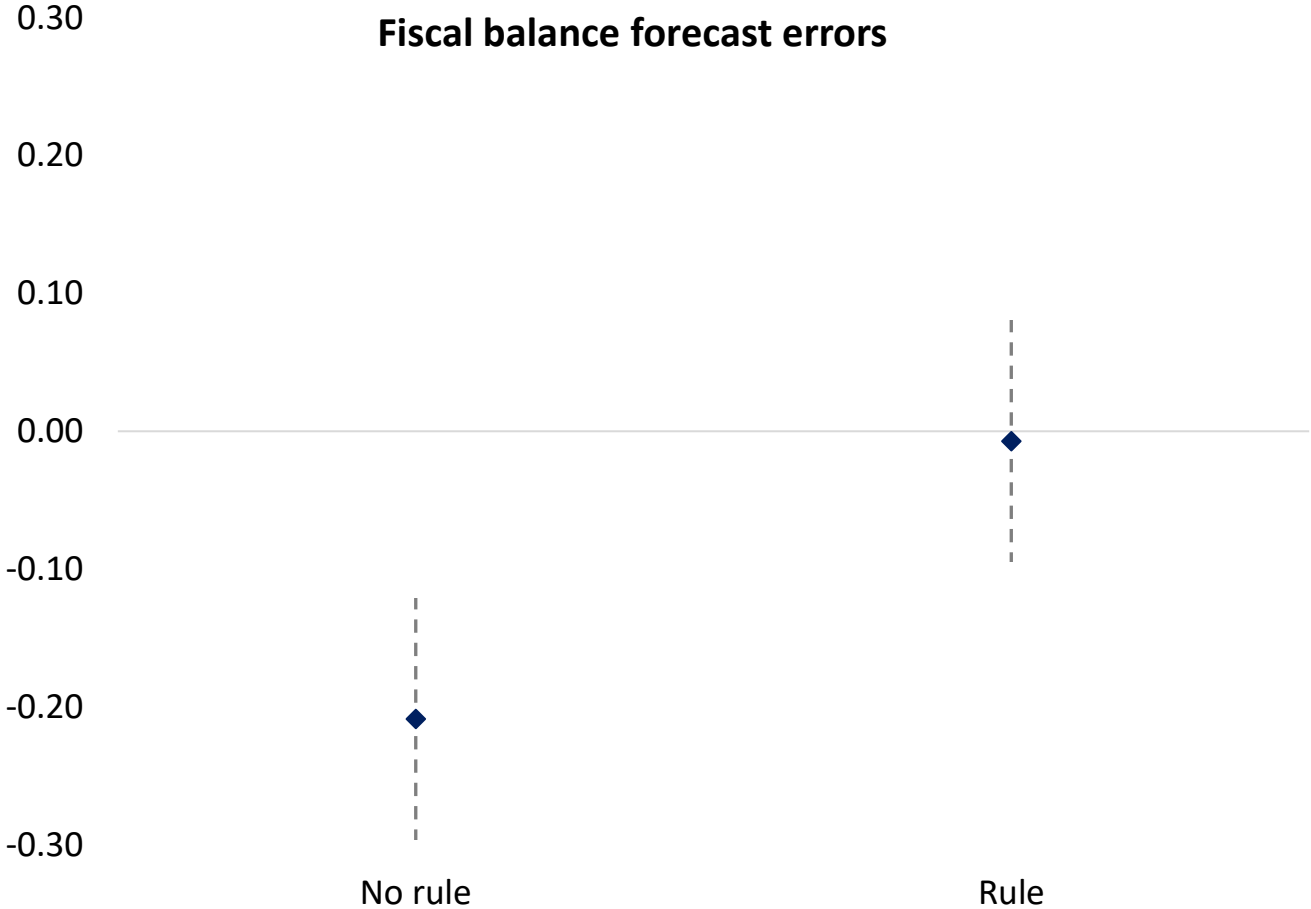


Fiscal balance forecast errors (p.p.)



Statistically significant differences : *** p<0.01, ** p<0.05, * p<0.1

Fiscal rules can reduce extent of over-optimism



Conclusions

- Fiscal rule effectiveness cannot be improved in isolation from the quality of the overall policy framework
- Mechanisms to foster **compliance** are key to enhance effectiveness of fiscal rules
- Strengthening **medium-term fiscal frameworks** that provide credible “forward guidance” as to how fiscal targets will be achieved in the future
- Establishing **fiscal councils** to increase reputational costs from deviating from rules and by having a say following periods of non-compliance on how the rule will be enforced

Fiscal institutions as *parchment barriers* to fiscal discipline?



*Will it be sufficient to mark, with precision, the boundaries of these departments, in the constitution of the government, and to trust to these **parchment barriers** against the encroaching spirit of power? (The Federalist Papers, XLVIII)*

References

[Fiscal Rules: Challenges and Reform Opportunities for Emerging Markets](#)

[Why Don't We Follow the Rules? Drivers of Compliance with Fiscal Policy Rules in Emerging Markets](#)

[Numerical Compliance with Fiscal Rules in LAC](#)

Thank you!