From pragmatic fiscal expansion to the Golden Rule of public investment

Input to the panel
‘Does Europe need new fiscal rules to enable investment?‘
European Dialogue 2016,
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Overview

- two problems: austerity and the neglect of public investment
- how not to solve the problems
- using the leeway within the current framework for fiscal expansion
- changing the rules: implementing the Golden Rule for public investment
The incredible degree of austerity

'Fiscal effort' as of EU-Commission spring 2014 (with potential output from Spring 2010):
Cumulative change in the primary structural balance in % of GDP, 2010-2014 (source: Truger 2015).
…the neglect of (net!) public investment

cumulative net public investment cuts in relation to consolidation volume in %

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
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<td>Euro area (12 countr)</td>
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<td>-</td>
<td>2</td>
<td>3</td>
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source: EU Commission ameco database February 2016; author’s calculations
how not to do it…

- further austerity
- further 'structural reforms' understood as dismantling the welfare state and deregulating the labour market
- further easing of restrictions for doing business
- further monetary policy expansion
- just decreasing the pace of consolidation
- Juncker-Plan and other evasion strategies
how to do it…

- direct substantial demand side stimulus necessary
  - somebody has to spend more
  - expansionary fiscal policy needed

- specific incentives for increasing public investment necessary
  - Golden Rule of public investment
8 ways to boost fiscal policy and strengthen public investment

<table>
<thead>
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<th>strengthening investment + expansionary overall fiscal policy stance</th>
<th>(1) more active use of the ‘investment clause’</th>
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<td>(2) allow for temporary investment programmes (analogous to EFSI)</td>
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<td>(3) interpret temporary investment programmes as structural reforms</td>
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<td>(4) incorporate realistic investment multiplier in budgetary analysis ex ante</td>
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<td>(5) use leeway in economically bad times</td>
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<td>(6) implement better methods of cyclical adjustment</td>
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<td>(7) temporarily higher spending with a view to Europe 2020 goals</td>
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<td>(8) use exception for severe downturn in EU or Euro area</td>
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Short term fiscal boost

- use severe downturn to boost to fiscal policy
- 2-3 years minimum 1 % of GDP stimulus per year
- e.g. spending on neglected Europe 2020 goals
  - research and education,
  - early childhood investment, child care
  - infrastructure maintenance and upgrading,
  - ecological renovation of homes and offices,
  - bottlenecks in energy and broadband grids
the golden rule for public investment

net public investment investment should should be financed by budget deficits

the reasons: intergenerational fairness & growth

- net public investment increases the public/social capital stock
- future generations inherit higher capital stock, productivity and growth
- pay-as-you-use principle: future generations contribute to financing via debt service
- otherwise present generations have to pay all of the burden
- otherwise: incentives for underinvestment, particularly in times of budgetary pressure
proponents of the golden rule

- Richard A. Musgrave (1939/1959)

- as reform for EU fiscal policy
  - Fitoussi/Creel (2002); Blanchard/Giavazzi (2004)
  - Barbiero/Darvas (of Bruegel) (2014); Dervis/Saraceno (2014)

- in German debate about the 'debt brake'
  - German council of economic experts (the 5 wise women/men) (2007) proposed the golden rule in their blueprint for the debt brake
defining public investment

Theoretically, any expenditure with a sufficiently high future return should qualify as investment

→ find expenditure categories that qualify on average

- traditional investment as defined in the national accounts?
- spending on education?
- spending on child-care?
- spending on social work and integration?
defining public investment

traditional investment as defined in the national accounts

- mainly tangible assets (construction, infrastructure, equipment, office machines, other capital goods with an economic life of more than one year)

- substantial short-term growth effects
  - new 'multiplier' debate: multiplier substantially larger than 1
  - Larger than for other spending categories and particularly than revenue-side measures

- substantial long-term growth effects
  - high rates of return (plus low interest rates!!)
defining public investment

traditional investment as defined in the national accounts

- after general revision of national accounts (ESA 2010)
  - includes spending on research and development
  - includes spending on military weapons systems
  - counts more firms/non-profit organisations as part of the government
- should be corrected for spending on weapons systems (-)
  and investment grants to private sector (+)
- depreciation should be deducted to focus on net investment

→ pragmatic definition of net investment
Implementing the golden rule in the EU fiscal framework

- deduct net public investment from relevant deficit numbers of the stability and growth pact
  - i.e. from headline deficit relevant for corrective arm
  - i.e. from structural deficit relevant for preventive arm

- set upper limit to deductible net investment of 1 to 1.5 % of GDP to ensure sustainability
The Golden Rule would not solve all problems, but…

- could provide substantial stimulus
- would create substantial further fiscal leeway as it is partly self-financing
- could be adapted according to
  - fiscal 'sustainability' goals
  - rebalancing requirements (current account)
  - integration needs into reformed versions of fiscal rules
  - better democratically determined definitions of public investment
Thank you very much for your attention!