

„New Fiscal Policy“

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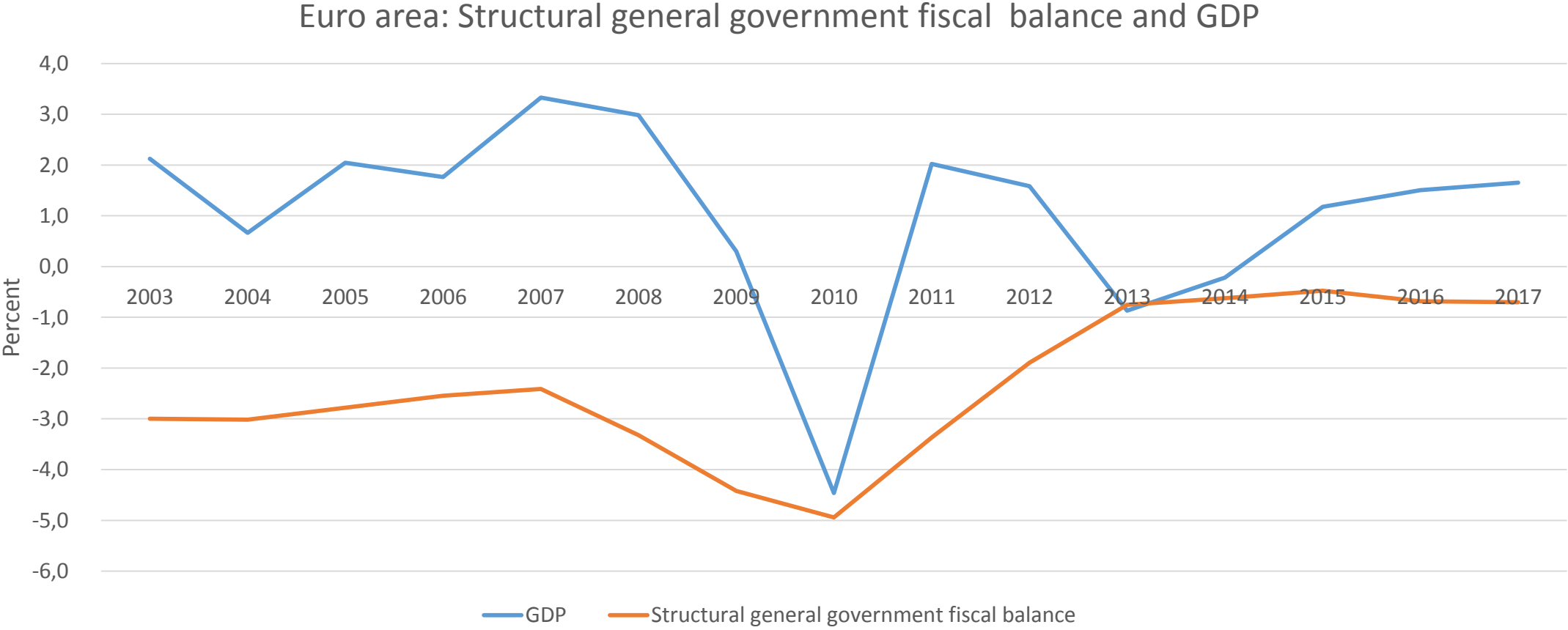
German Council of Economic Experts

Furman: Five Principles of the New View of Fiscal Policy

1. Fiscal policy is often beneficial for effective countercyclical policy as a **complement to monetary policy**
2. Discretionary fiscal stimulus can be very effective and in some circumstances can even **crowd in private investment**. To the degree that it leads to higher interest rates, that may be a plus, not a minus.
3. Fiscal space is larger than generally appreciated because **stimulus may pay for itself** or may have a lower cost than headline estimates would suggest; countries have more space today than in the past ; and stimulus can be combined with longer-term consolidation
4. More sustained stimulus, especially if it is in the form of effectively targeted investments that **expand aggregate supply**, may be desirable in many contexts.
5. There may be larger benefits to undertaking **coordinated fiscal action** across countries

Jason Furman, Chairman, Council of Economic Advisers, The New View of Fiscal Policy and Its Application, Conference: Global Implications of Europe's Redesign, New York, NY, October 5, 2016

The paradigm change has worked in the Euro area



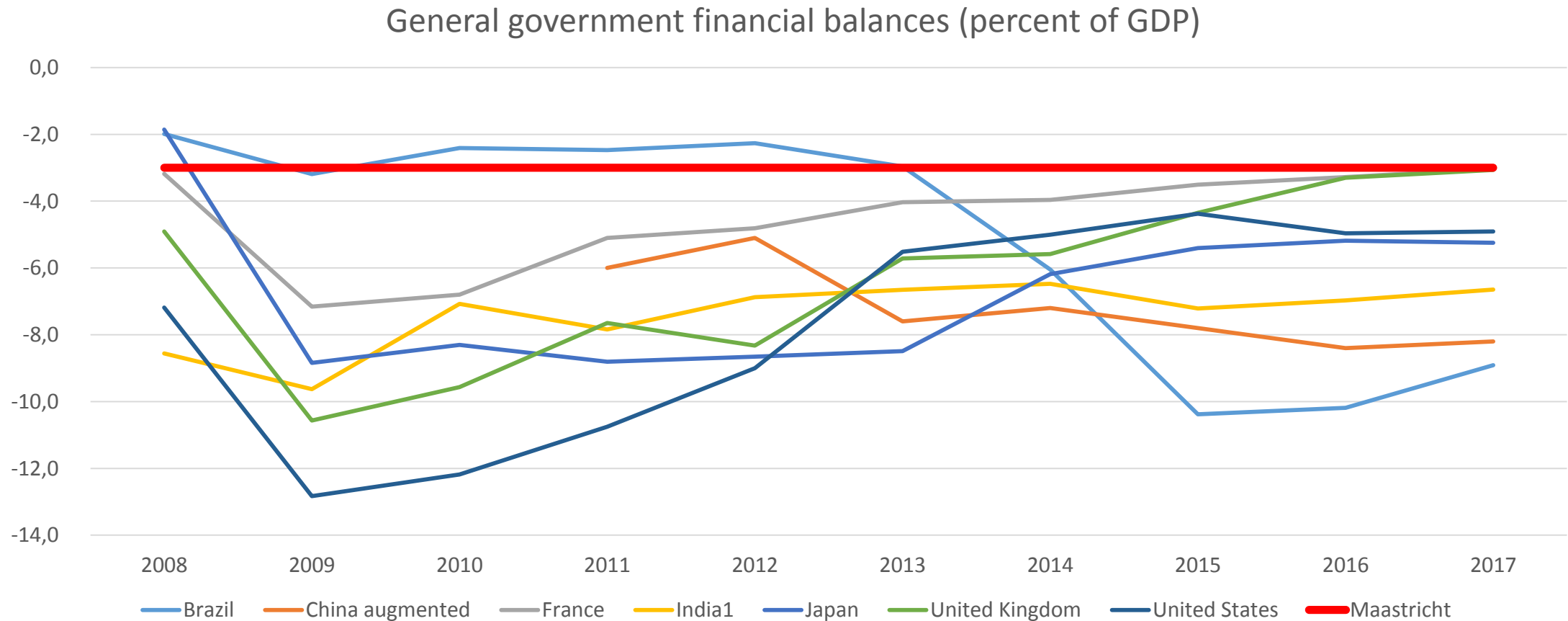
Source: OECD

Fiscal rules and the categorical imperative

Immanuel Kant:

"Act only according to that maxim whereby you can at the same time will that it should become a universal law."

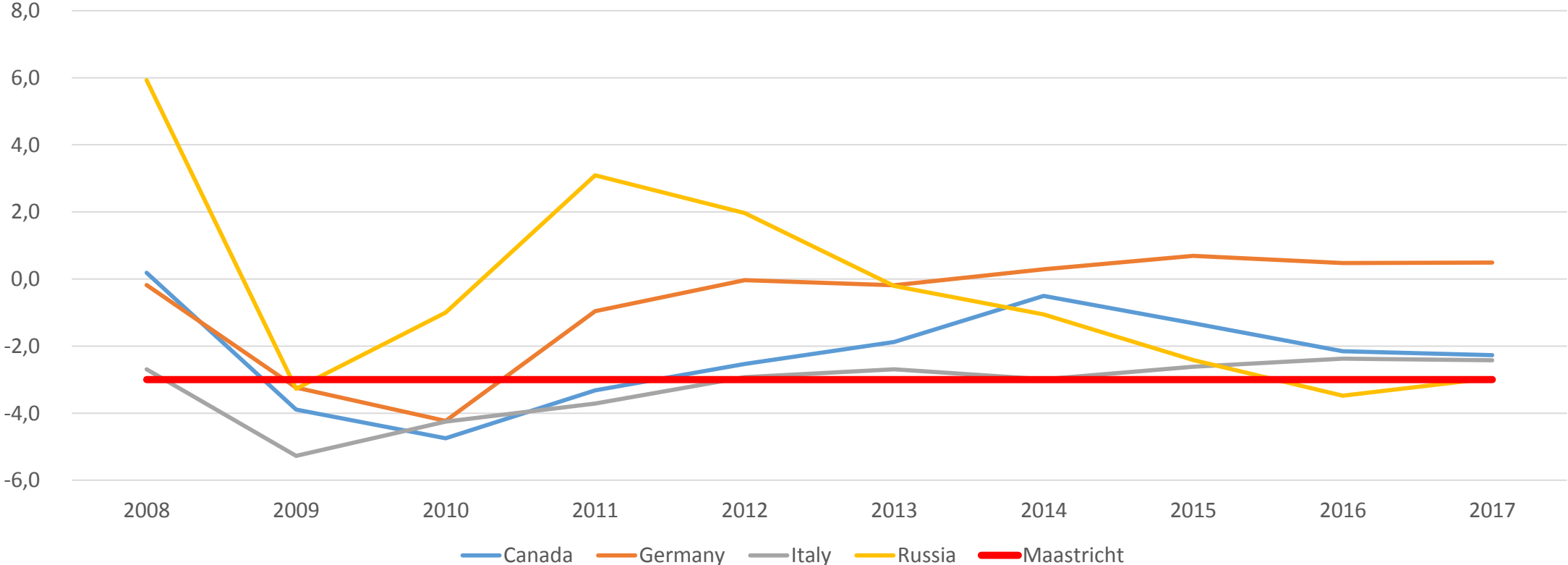
Most large economies have failed to reach the 3 % deficit. „Black Zero“ is out of sight.



Source: OECD and IMF

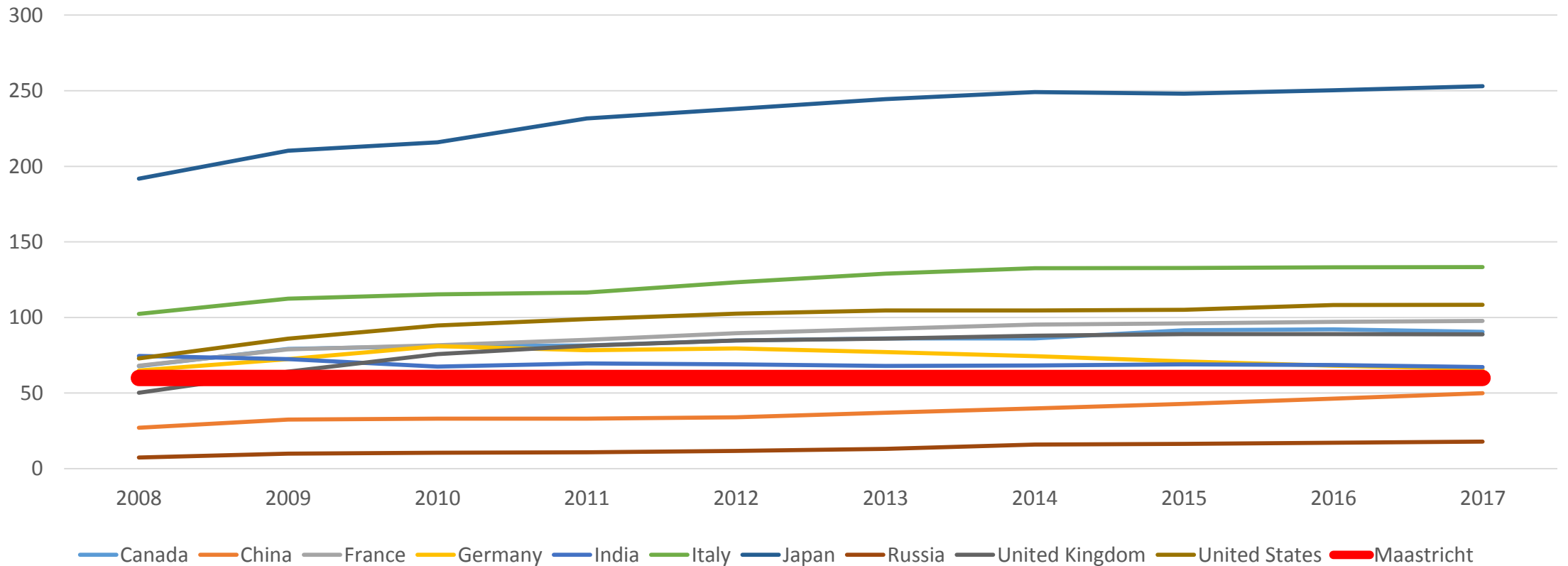
The small „Club of the Virtuous“

General government financial balances (percent of GDP)



For Japan, Italy, the US, France, and the UK the 60 % threshold is out of reach

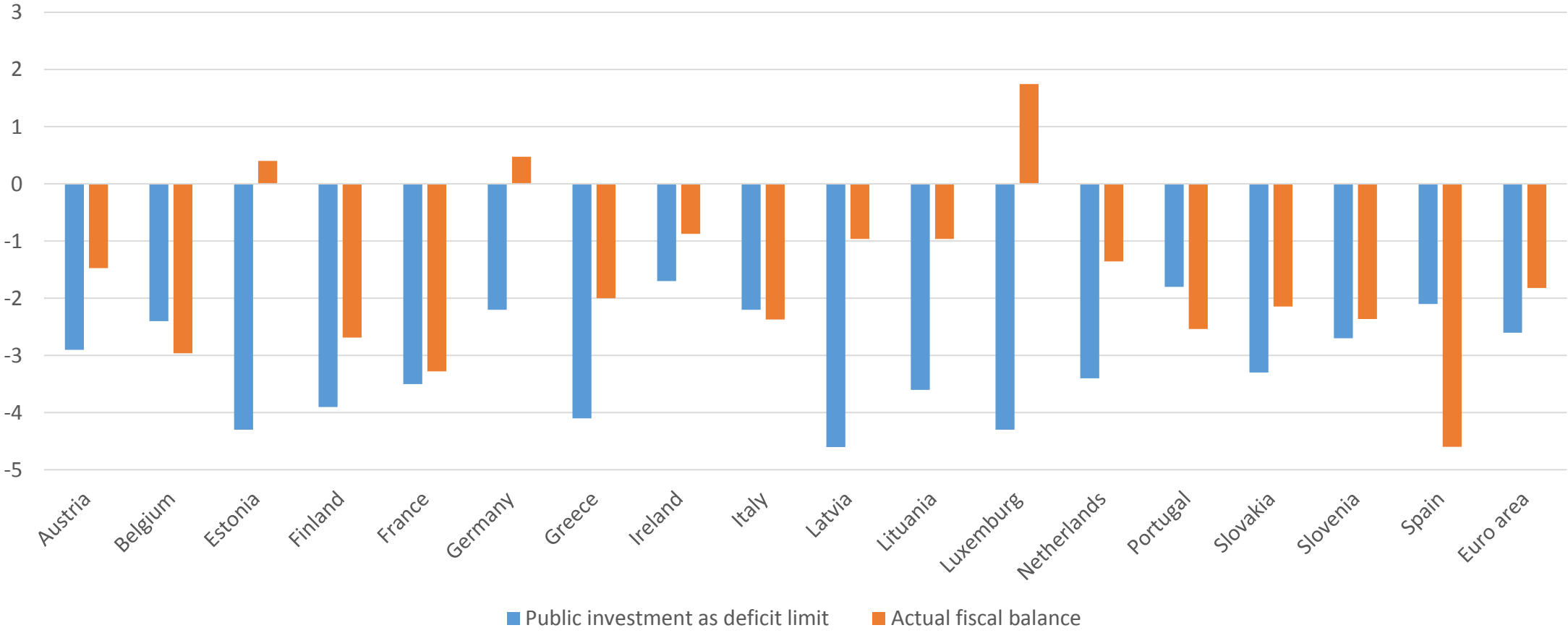
General government gross debt (percent of GDP)



A set of new rules

- For the **gross debt ratio**: The 60 % threshold of Maastricht is completely arbitrary. A debt level of 100 % seems unproblematic for large economies.
- For the **deficit limit**: The 3 % threshold is derived from the 60 % threshold of Maastricht. As it assumes a 5 % nominal GDP growth it is no longer applicable. A 100 % threshold for the debt ratio can be stabilized with a 3 % deficit under the more realistic assumption of 3 % nominal GDP growth.
- In order to provide space for serious recessions, the **medium-term budgetary objective** of the SGP should be lower than 3 %, but it can be raised to 2%.
- In line with the „**Golden Rule**“ the deficit would require a corresponding amount of public investment,
- Countries which are currently exceeding the 100 % limit for the debt ratio would be able to converge to the limit over time.
- The **fiscal compact** should be abolished.

The „golden rule“ would be compatible with the 2% medium fiscal objective



The new fiscal framework

	Debt/GDP-limit	Nominal GDP growth assumption	Deficit-Limit	Medium-term budgetary objective	Implicit Debt/GDP-target 60%	Golden rule
Maastricht Treaty	60 %	5 %	3 %	-	60 %	No
Stability and Growth Pact/ Fiscal Compact	60 %	5 %	3 %	Structural deficit: 0.5%	10,5 %	If GDP growth is negative or GDP remains well below its potential
New Framework	100 %	3 %	3 %	Structural deficit: 2 % according to public investment.	100 %	Public investment can be deficit financed up to 2 % of GDP

The EZ needs an economic enlightenment

Immanuel Kant: What Is Enlightenment? (1784)

„Enlightenment is man's emergence from his self-imposed nonage. Nonage is the inability to use one's own understanding without another's guidance. This nonage is self-imposed if its cause lies not in lack of understanding but in indecision and lack of courage to use one's own mind without another's guidance. *Dare to know! (Sapere aude.)* 'Have the courage to use your own understanding,' is therefore the motto of the enlightenment.”