Summary for non-specialists
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Evaluating Fiscal Policy
A Rule of Thumb

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This paper presents a rule of thumb for evaluating the macroeconomic aspects of fiscal policies in Economic and Monetary Union (EMU) The rule under study puts at its centre a balancing act between the requirements of fiscal discipline and economic stabilisation, seen as two aspects of macroeconomic stability. Fiscal discipline is anchored in a long-run objective of gradually achieving a moderate level of public indebtedness. Economic stabilisation is broadly understood as output stabilisation.

As another key feature, the "target" of the rule is the evolution of primary public expenditure adjusted for the impact of discretionary revenue measures. The key attraction of such measure is to offer a good reflection of underlying fiscal policy actions, better so than traditional indicators such as cyclically-adjusted balances. In a nutshell, the essence of the rule of thumb is to connect the long-run objective of public debt control to a measure of fiscal effort closely connected to annual budgetary decisions, while taking into account in a transparent manner the possible short-run trade-offs with output stabilisation.

The examined rule of thumb has a heuristic flavour. In analogy with a Taylor rule in monetary policy analysis, it can be viewed in either normative or positive terms. In the first instance, it sets a target, or at least suggests a default starting point, for conducting budgets in a sensible manner. In the latter case, it defines a standard against which the fiscal stance may be characterised.

The properties and implications of this rule are discussed qualitatively, and further analysed in the paper through retrospective simulations over the past decade across EMU countries. While specific conclusions are country and period-dependent, the overall emerging picture is one of insufficient fiscal consolidation in moderate to good times. By contrast however, fiscal tightening has significantly overshot the benchmark given by the rule in the 2011-2013 consolidation period, particularly so in several countries of the euro area 'periphery'.

Overall, the rule of thumb offers a pedagogical filter for appraising fiscal policies in a simple, cross-country and time-consistent manner. We find that the rule of thumb: offers a parsimonious approach to fiscal policy; adopts a broad view of fiscal soundness; is of a prescribing, not proscribing nature; focuses on the achievement of an appropriate policy stance while containing an in-built debt regulation mechanism.