

Fiscal Institutions and Debt Sustainability: Do fiscal rules make a difference?

**WORKSHOP ON INTERNATIONAL MACRO
RIDGE / BANCO CENTRAL DEL URUGUAY**

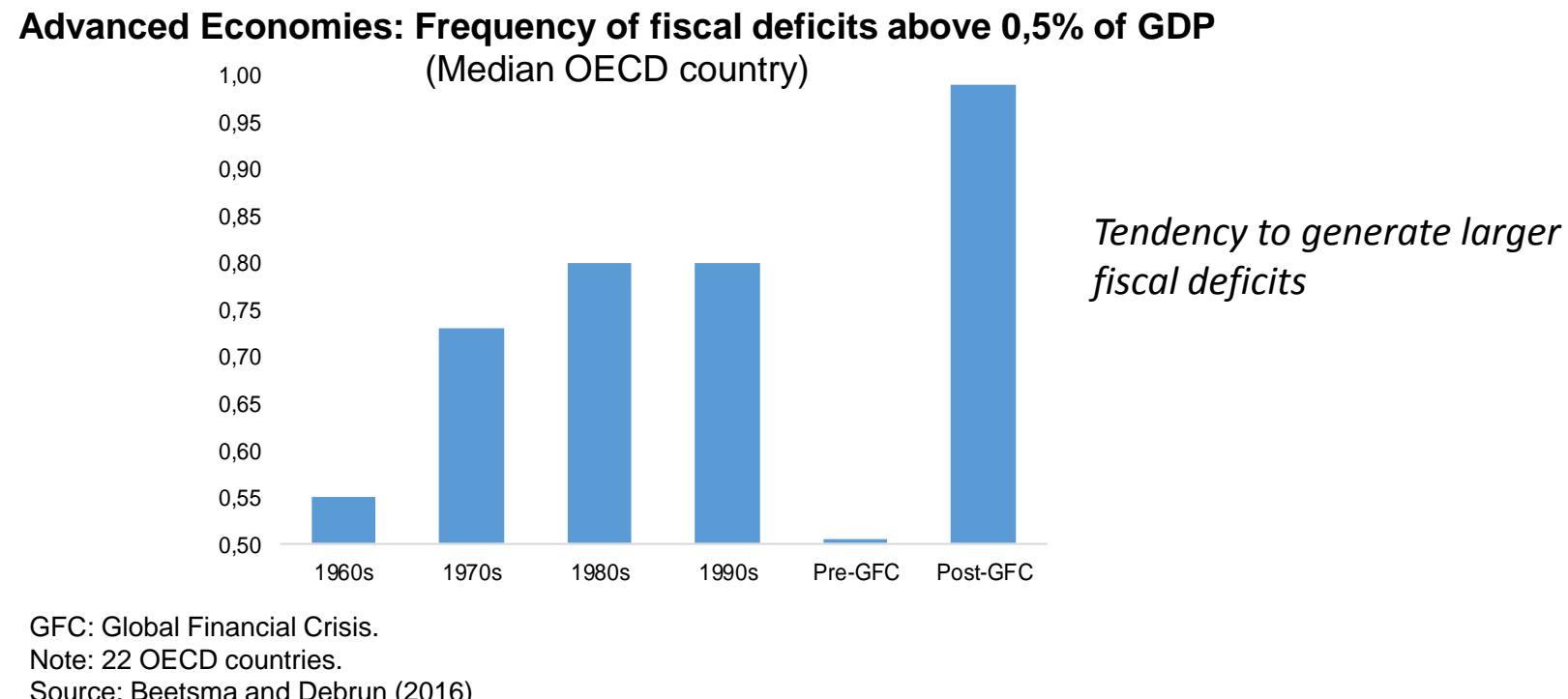
Eduardo Morón
Consejo Fiscal del Perú

December 2017

Which is the role of fiscal rules?

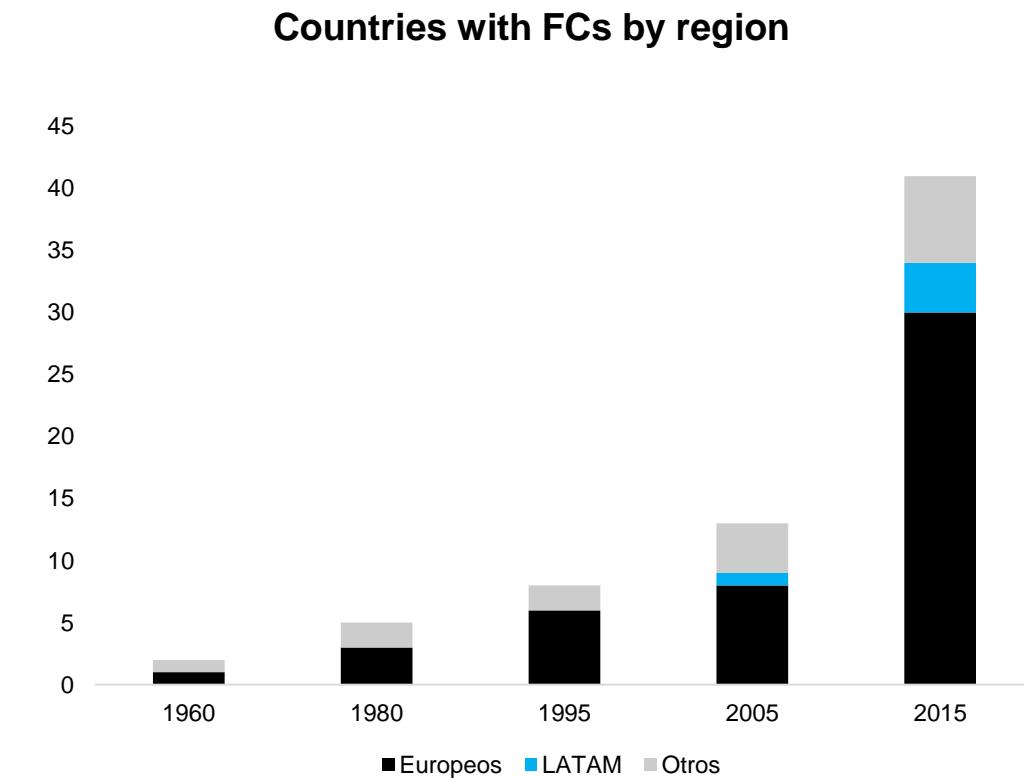
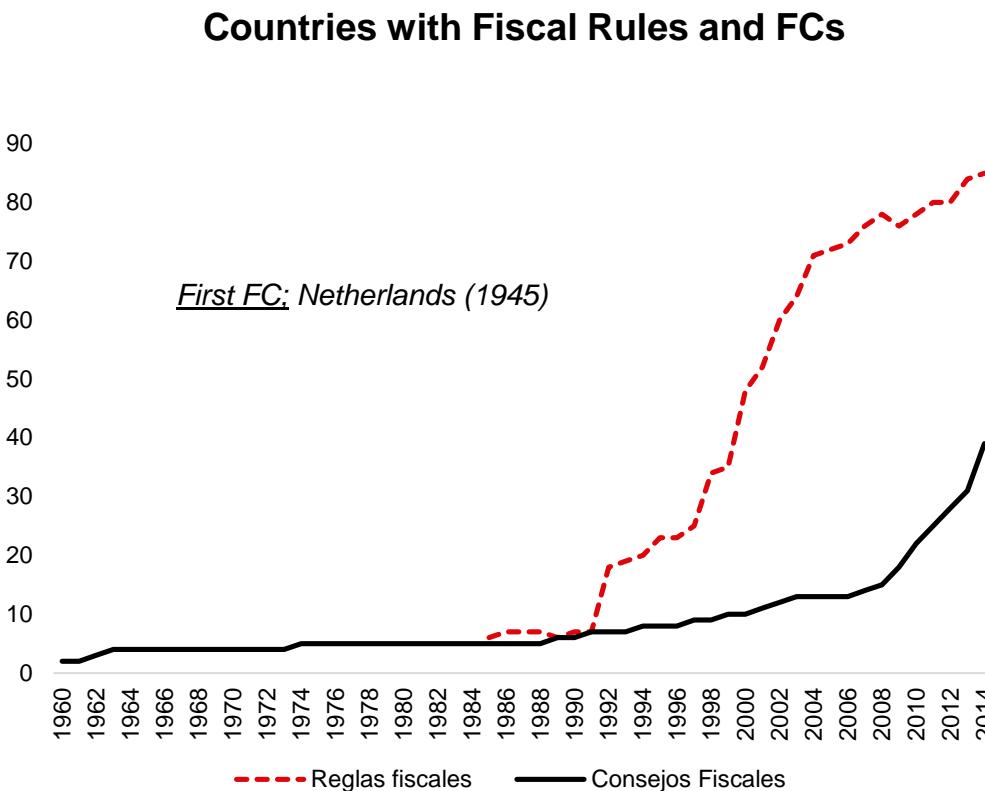
The promise of fiscal rules

- Fiscal rules are permanent restrictions on fiscal policy, expressed in terms of a fiscal performance indicator (Kopits y Symansky 1998).
- Their objective is to strengthen long-term fiscal sustainability, avoiding biases in the formulation of fiscal policy such as: myopic fiscal policies, time inconsistencies, political cycle, voracity in booms, and others.
- Governments tend to run fiscal deficits to satisfy political objectives.



Fiscal Councils as complements of fiscal rules

- Creation of FC is not a recent trend.
- In the last years, with the adoption of fiscal rules, more countries have also adopted fiscal councils.

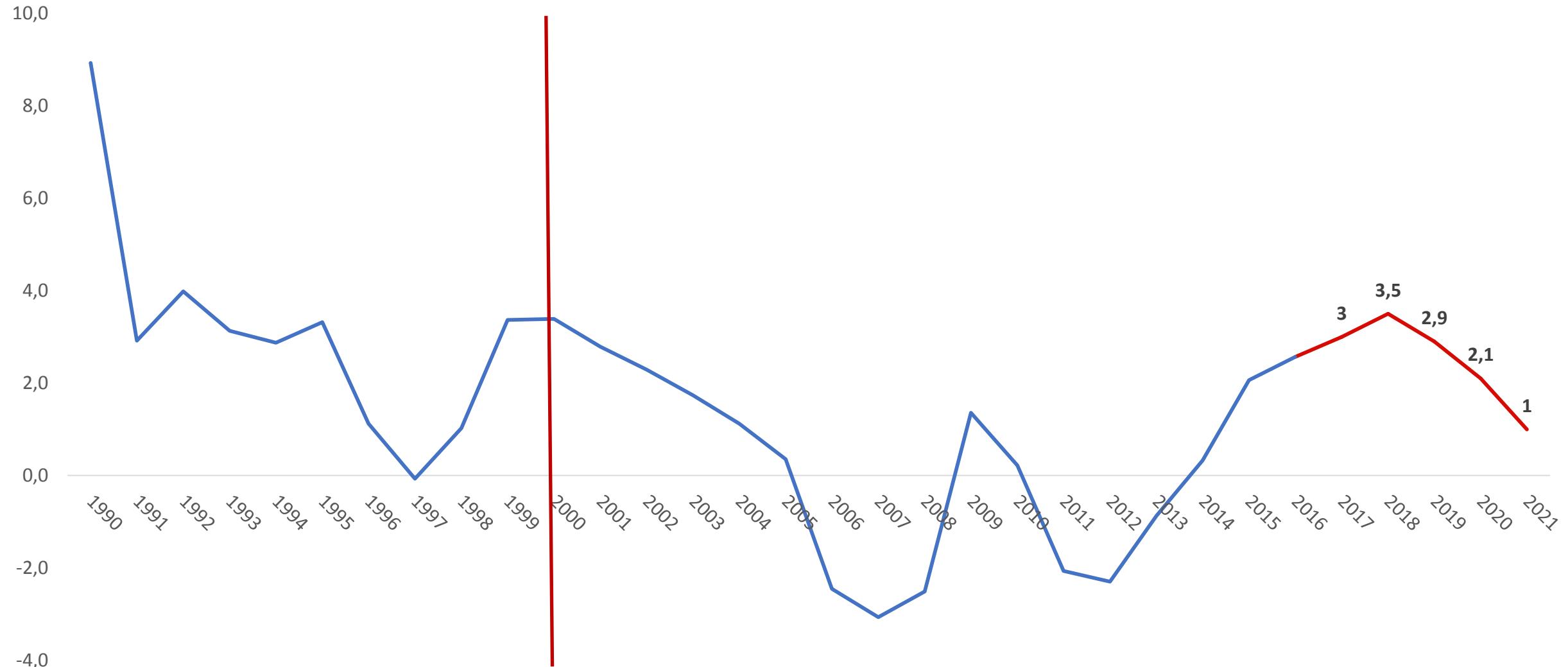


Source: Debrun y Kinda, 2014, "Strengthening Post-Crisis Fiscal Credibility - Fiscal Councils on the Rise. A New Dataset", IMF working paper; y Beetsma y Debrun, 2016, "Fiscal Councils: Rationale and Effectiveness", IMF working paper.

Where was Peru before the adoption of Fiscal Rules?

- High public debt ratios
- Recurrent fiscal deficit
- Centralized government structure
- Highly procyclical fiscal policy

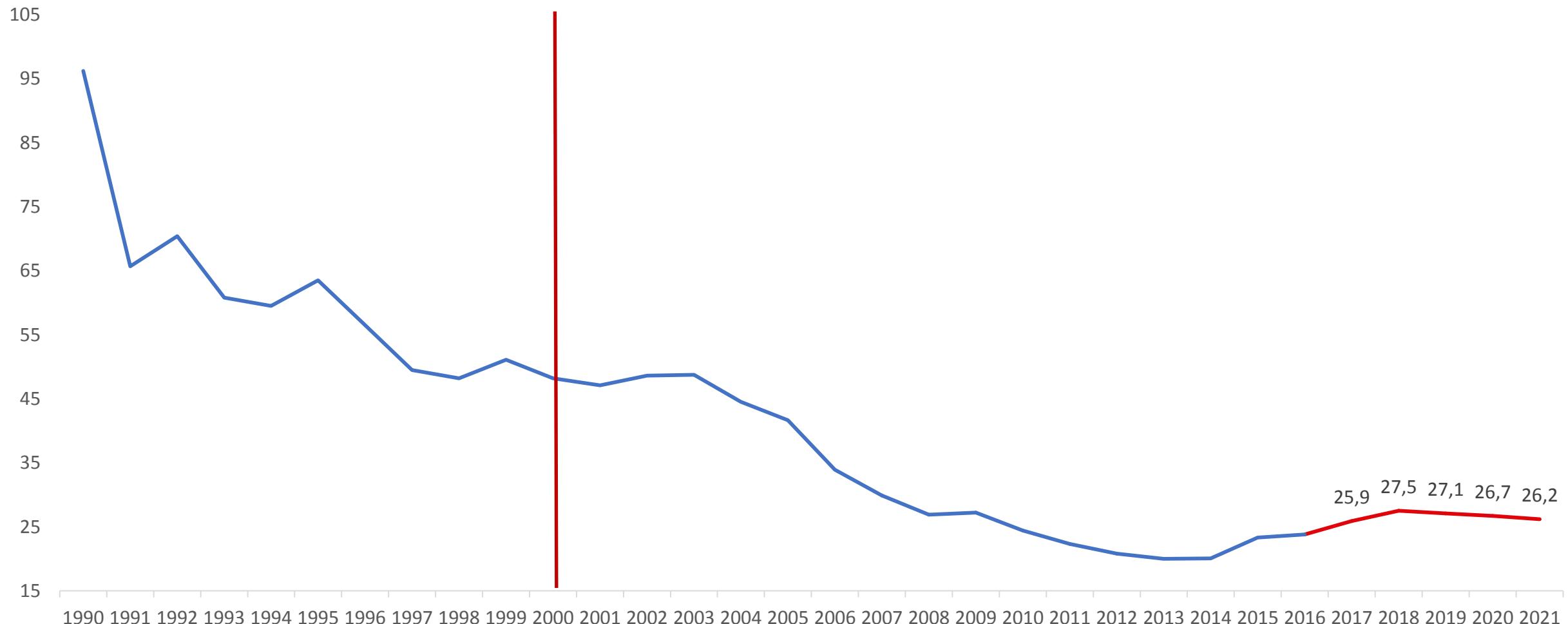
Fiscal Deficit (% of GDP)



Source: Central Bank. Red line shows official fiscal targets.

Elaboration: Fiscal Council of Peru

Stock of Public debt (as % of GDP)



Source: Central Bank. Red line shows official projections.

Elaboration: Fiscal Council of Peru

Peru: the evolution of our fiscal rules

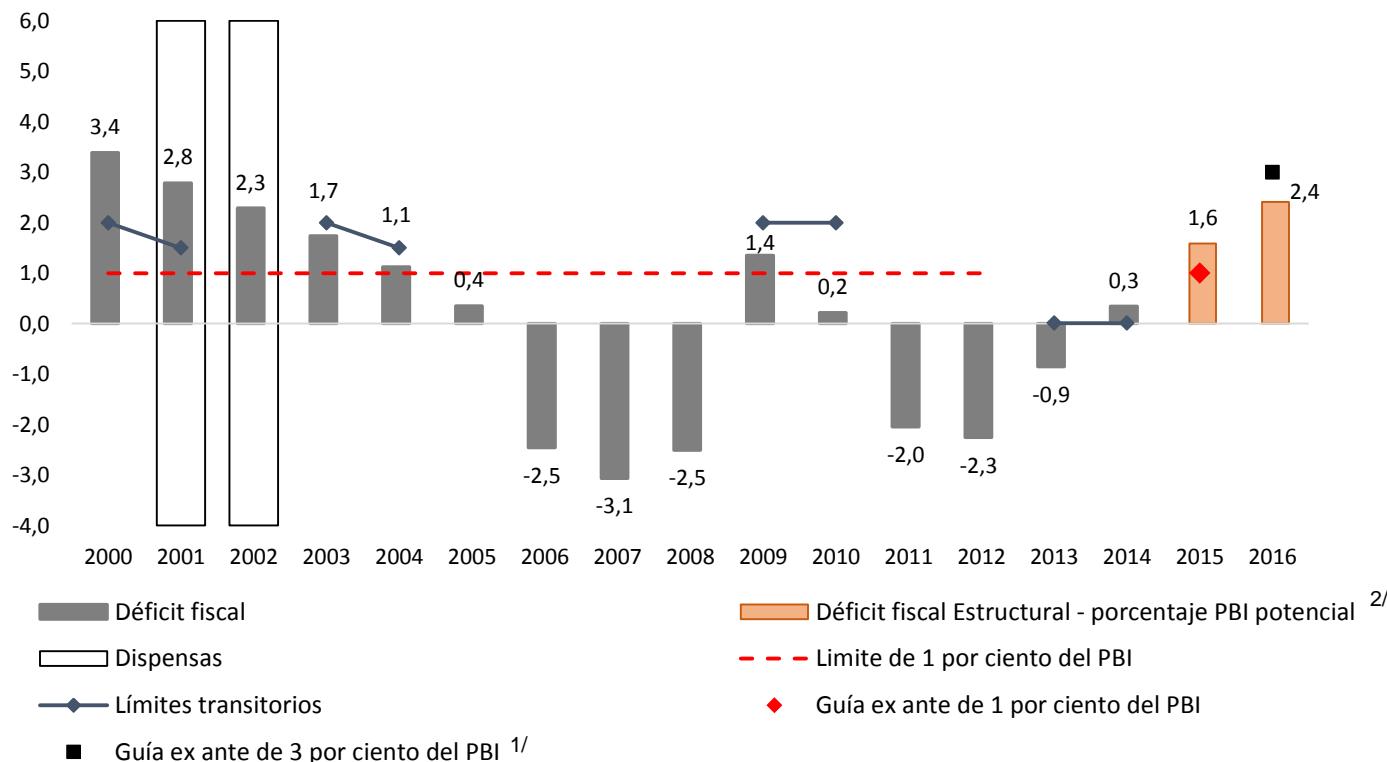
Timeline

1999	→ Ley de Prudencia y Transparencia Fiscal (Ley N° 27245) <i>Rules based on observable variables:</i> <ul style="list-style-type: none">- <i>Límits on public fiscal deficit;</i>- <i>Límits on public expenditure real growth; and</i>- <i>Límits on public debt growth</i>
2003	→ Ley de Responsabilidad y Transparencia Fiscal (LRTF, Ley N° 27958) <i>Introduced fiscal rules for subnational governments</i>
2013	→ Ley de Fortalecimiento de la Responsabilidad y Transparencia Fiscal (LFRTF, Ley N° 30099) <i>Rules. Based on structural variables, non observables:</i> <ul style="list-style-type: none">- <i>Rule on Non Financial Expenditure of General Government based on an ex ante rule for the structural fiscal balance;</i>- <i>Rule on General Government expenditure on pensions and salaries based upon the growth rate of potential GDP.</i>
2016	→ Marco de la Responsabilidad y Transparencia Fiscal del SPNF (Decreto Legislativo N° 1276) <i>Rules based on observables</i> <ul style="list-style-type: none">- <i>Rule on debt</i>- <i>Rule on fiscal balance</i>- <i>Rule on non financial expenditure of General Government</i>- <i>Rule of current expenditure of General Government</i>

Peru: Fiscal rule on fiscal balance (2000-2016)

- Hard to implement. Government ask for waivers and temporary limits.
- Since 2004, a fiscal boom ease the fiscal consolidation process.

Fiscal Deficit and rule on fiscal balance



1/ En el Decreto de Urgencia N° 003-2015 se modifica la guía ex ante del resultado fiscal estructural del SPNF del 2016 a -3 por ciento del PBI.

2/ Proyecciones para el año 2016 del MMMR 2017-2019.

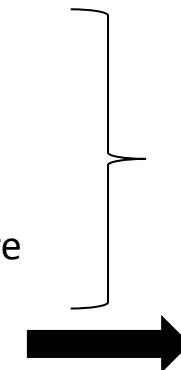
Fuente: Consejo Fiscal del Perú.

Peru: New Fiscal Rules – 2016 (MRTF)

1. Rule on debt: limit of 30% of GDP for gross debt (plus 4% in financial instability context).
2. Rule on fiscal balance: limit of 1% fiscal deficit fiscal as % of GDP.
3. Rule on Non financial expenditure: limit to the real growth rate of non financial expenditures (upper limit of the 20 year average of the real growth of GDP +/- 1p.p.)
4. Rule on current expenditure: limit to the real growth of current expenditure of General Government, excluding maintenance of infrastructure (lower limit of the 20 year...)

How do these rules interact?

- 1.- Rule on debt
- 2.- Rule on fiscal balance
- 3.- Rule of non financial expenditure
- 4.- Rule on current expenditure



Joint compliance defines the level of non financial expenditure of general government

Defines the composition of non financial expenses of general government

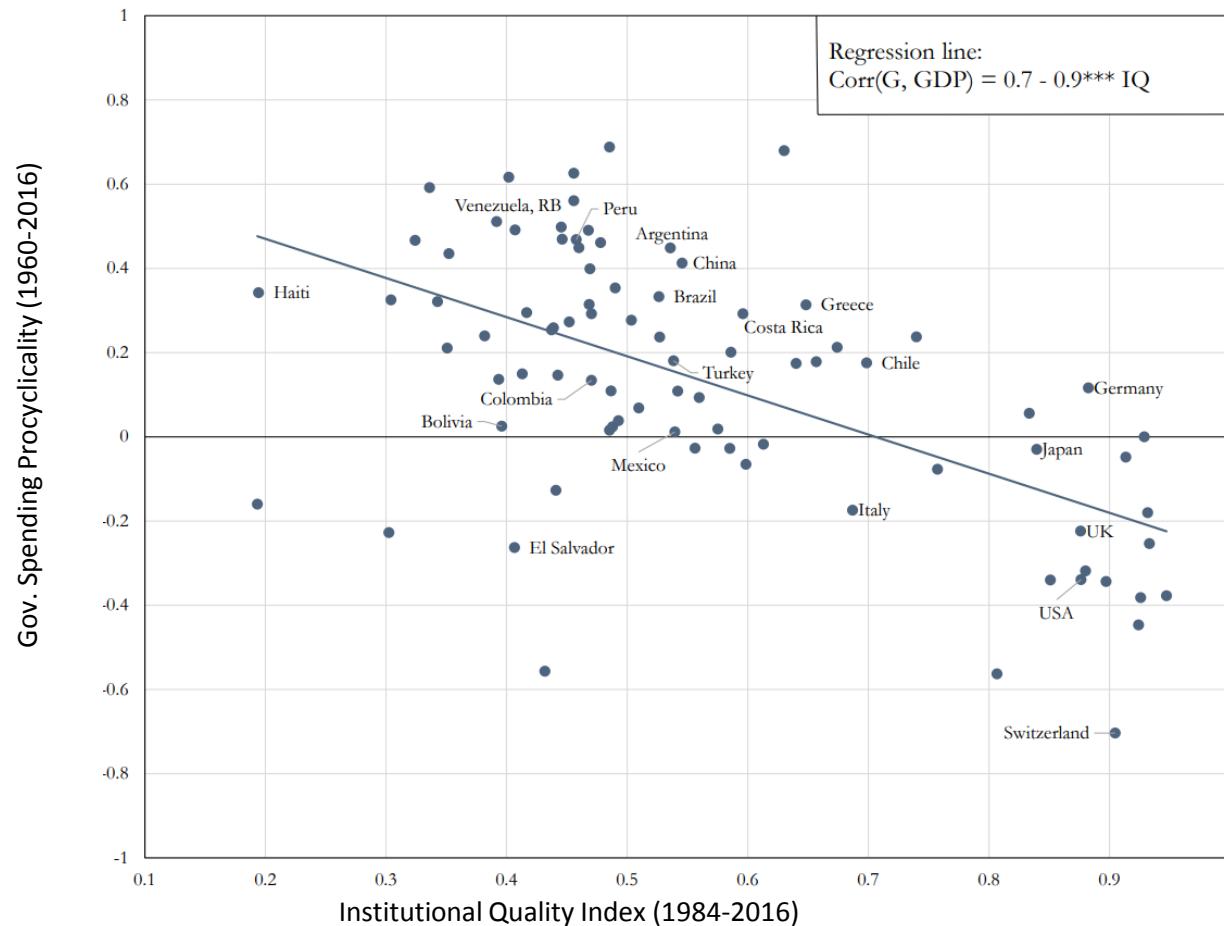
Do fiscal rules make the difference?

What has been achieved?

- Fiscal consolidation has reduced stock of public debt to very tolerable levels. Net public debt is less than 10% of GDP.
- Sovereign debt ratings at investment grade since 2007.
- Interest rates on public debt are among the lowest in the region.
- Less procyclical fiscal policies.

Institutions and Fiscal Procyclicality in LAC

- World Bank (2017) shows that institutions might help reducing fiscal procyclicality.
- Following fiscal rules, enhanced transparency and a much better fiscal performance improve institutional quality.



Source: "Leaning against the wind" Banco Mundial. April 2017.

Peru: Less fiscal procyclicality

	Hasta la década de los 90's			Posteriormente		Otros periodos			
	1968-1998	1980-1993	1980-1989	1994-2005	1994-2006	1960-2006	1980-2005	2006-2012	2007-2016
Ingresos corrientes ¹	0,09								
Gastos no financieros ¹	0,21								
Inversión pública ²		0,80		0,60					
Consumo público ²		0,60		0,40					
Gasto público ³			0,92		0,72	0,48			-0,09
Ingresos tributarios ³			0,76		0,59				
Variación del Resultado primario ajustado ⁴						0,20*	0,152*		
Variación del Resultado primario sin commodities ⁴						-0,19**	0,00*		
Variación del Gasto primario ⁴						0,65**	-0,59**		

¹ Vásquez y Mesías, 1999. La prociclicidad se mide como la respuesta de cada variable al ciclo económico.

² Castillo, Montoro y Tuesta, 2007. La prociclicidad se mide como la correlación del ciclo de cada variable con el ciclo económico.

³ Mendoza y Melgarejo, 2008; y Banco Mundial, 2017. La prociclicidad se mide como la correlación del ciclo de cada variable con el ciclo económico.

⁴ Klemm, 2014. La prociclicidad se mide como la respuesta discrecional en cada variable al ciclo económico. El resultado primario sin *commodities* excluye los ingresos provenientes de estos recursos.

* No significativos estadísticamente

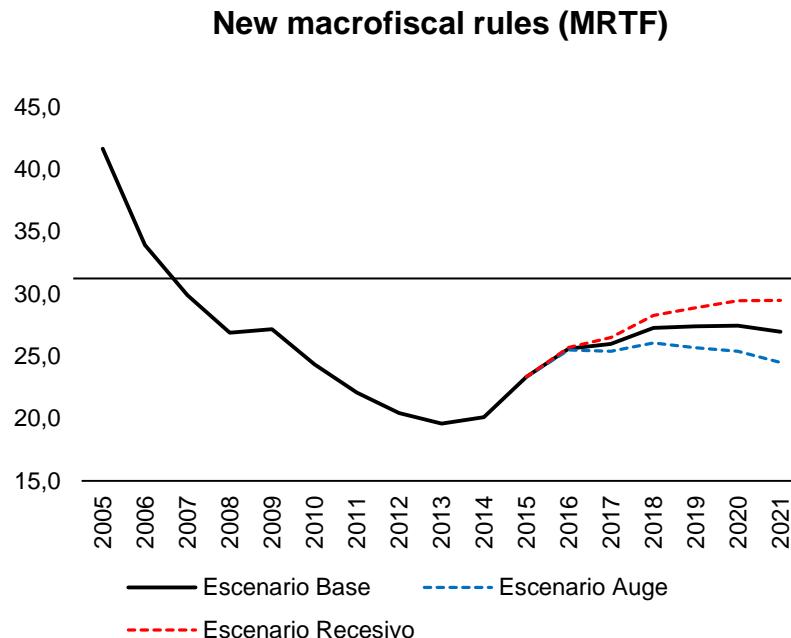
** Significativos estadísticamente

Elaboración: Consejo Fiscal del Perú.

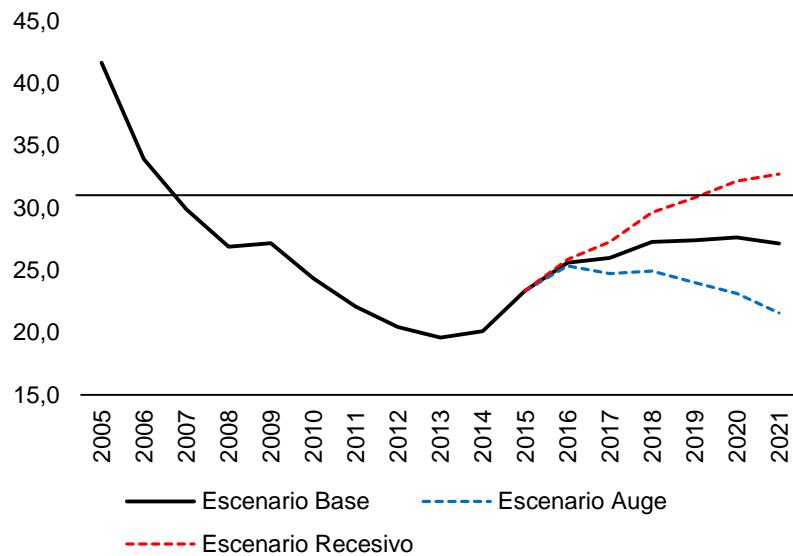
Peru: fiscal rules and public debt

- New set of macrofiscal rules (MRTF) generates a less volatile public debt ratio.
- New set of macrofiscal rules (MRTF) prevents the debt ratio to hit the legal limit of 30% of GDP (due to the activation of the deficit rule in the “recessive” scenario).

Simulation path for the public debt (% of GDP)



Previous rules (LFRTF)

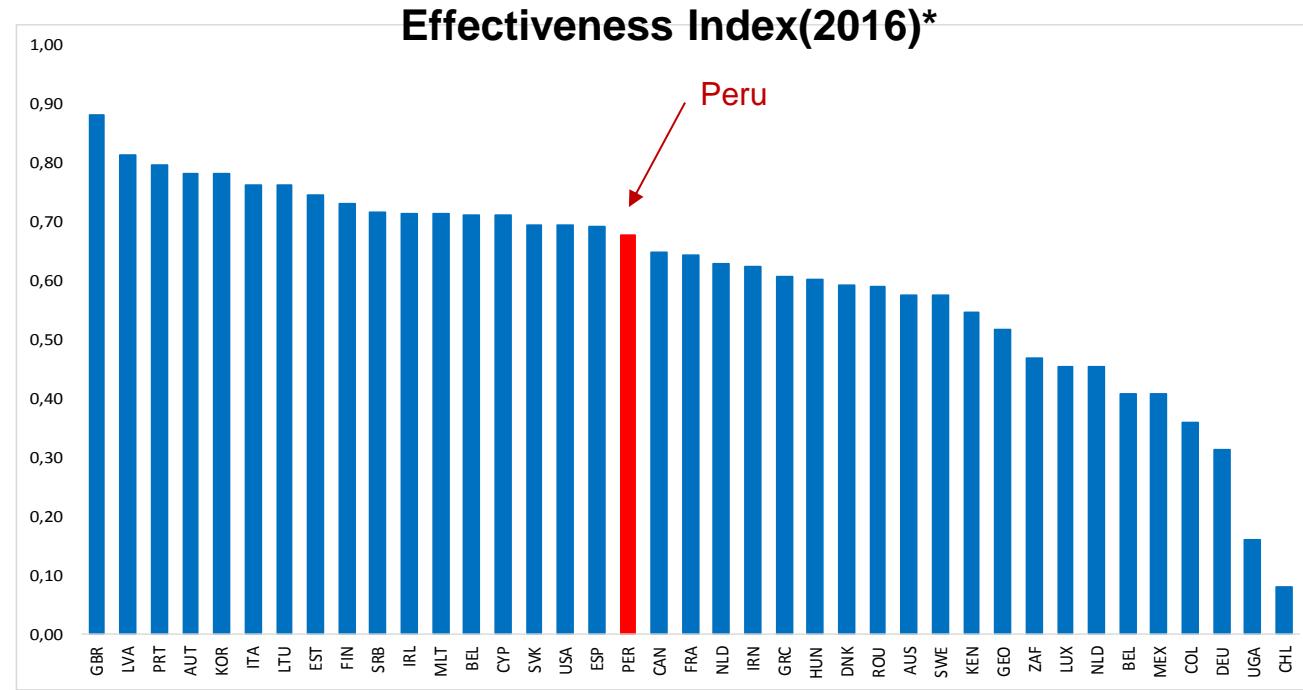


1/ El “Escenario de Auge” se compone de choques positivos sobre el “Escenario Base”, equivalentes a un cuarto ($\frac{1}{4}$) de la desviación estándar en 2016, y una (1) desviación estándar en cada año durante el periodo 2017-2021. El “Escenario Recessivo” consta de los mismos choques sobre el “Escenario Base” pero con signo negativo. Entre los años 2012-2015, las desviaciones estándar del crecimiento del IPX minero, IPX de hidrocarburos y PBI, equivalen a 5,8 por ciento; 20,5 por ciento y 1,8 por ciento respectivamente.

Elaboración: Consejo Fiscal del Perú.

Fiscal councils: effectiveness index

- Beetsma and Debrum (2016) proposes an index to measure the level of effectiveness among fiscal councils.
- “Effectiveness”: capacity to ensure public access to relevant budgetary information.



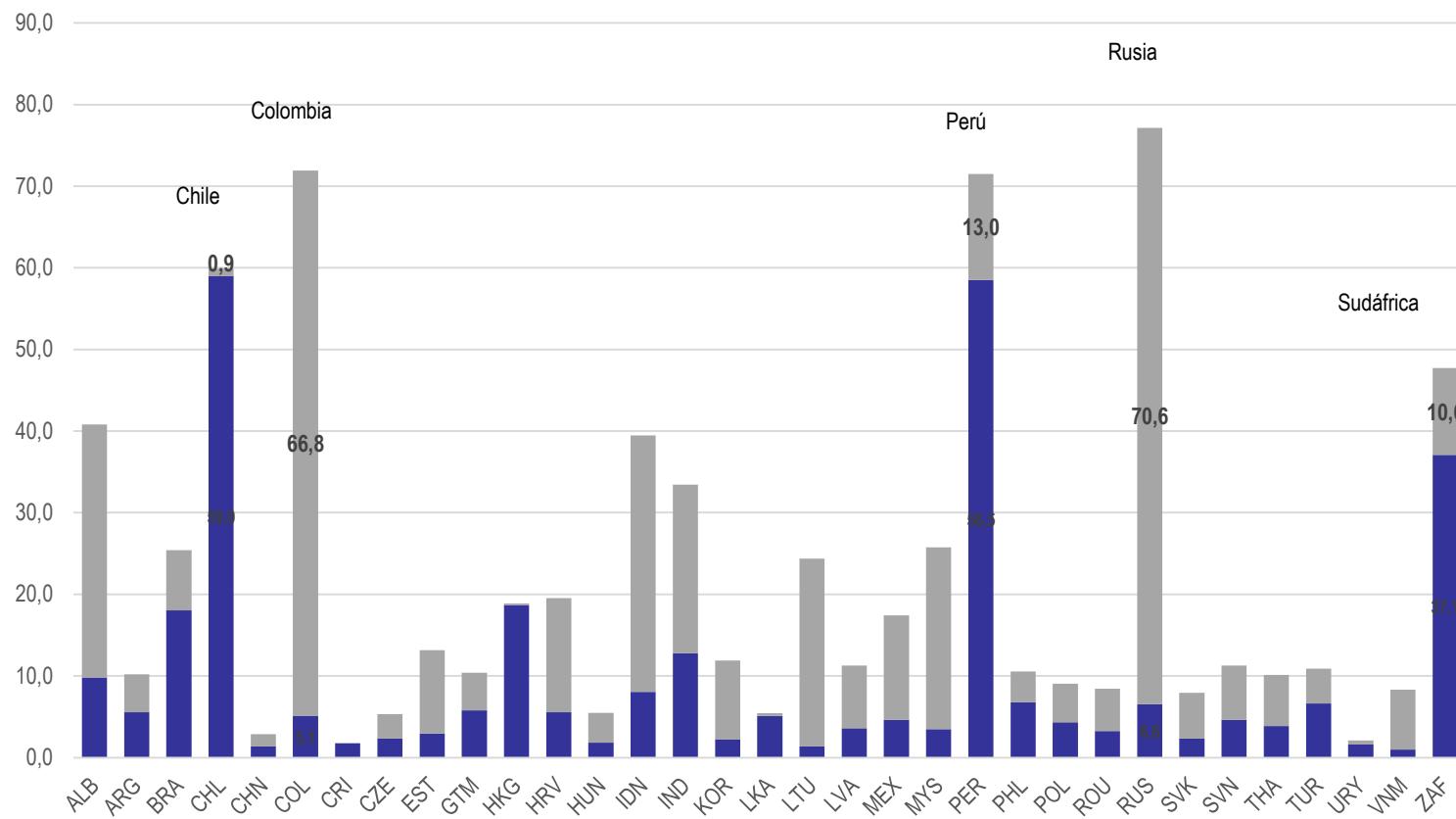
*Updated to 2016 by Fiscal Council of Peru

- Peru ranks 18 among 39 fiscal councils, with a higher score than Chile (39°), Colombia (36°) and Mexico (35°).
- The position of the Peruvian Fiscal Council is due to the high level of “political independence” with respect to its peers (one of the index components).

Which are the pending challenges?

- Low level of fiscal revenues along with temporary revenues coming from extractive sectors which are volatile.
- A decentralized government structure in which coordination is not guaranteed nor built-in.
- Lack of proper automatic stabilizers.
- Fiscal policy is not about driving a SMART car but a huge aircraft carrier. Nonsense to dream on fine tuning.

Commodity exports as % of total exports

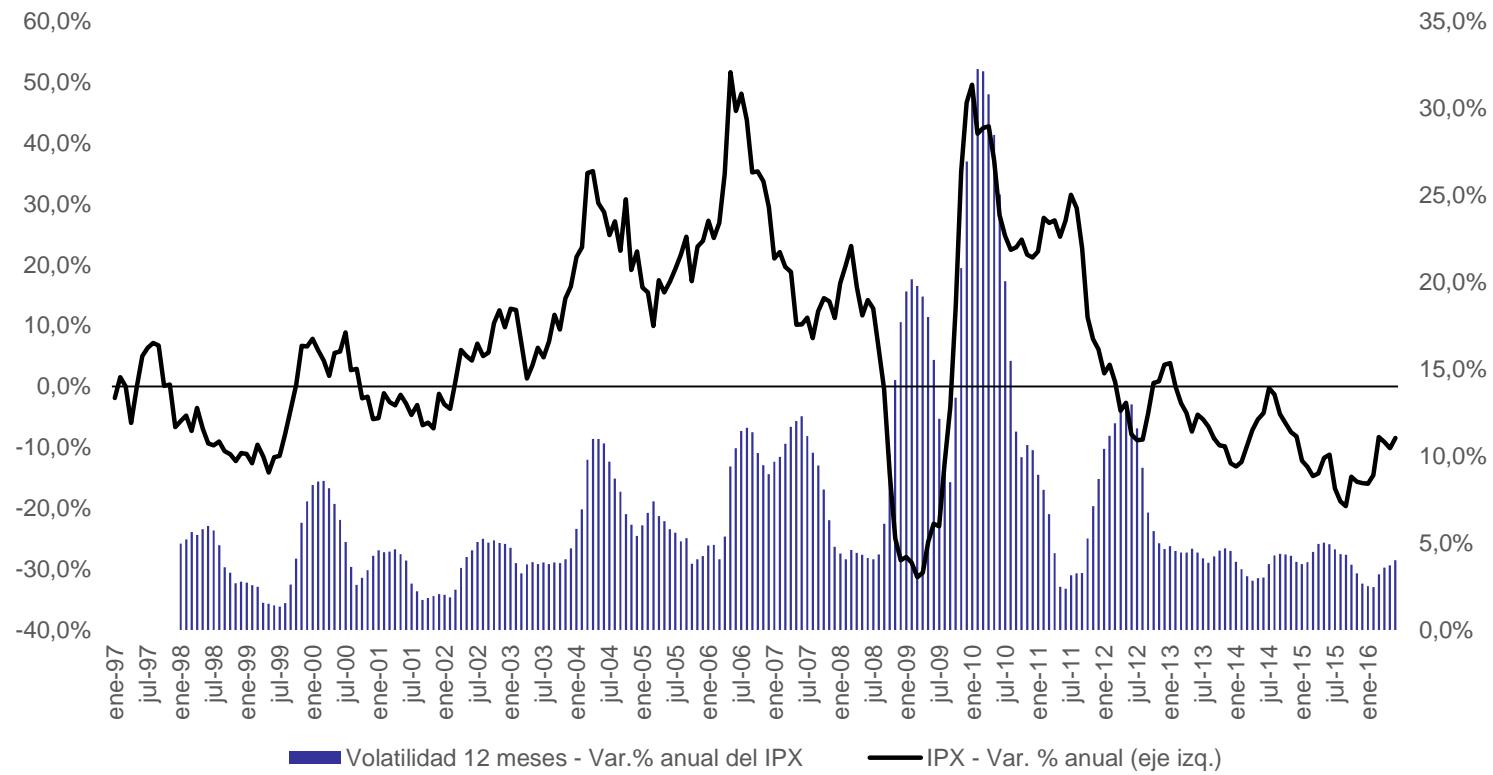


Source: United Nations and Fiscal Council of Peru

■ mineras ■ combustibles

Highly volatile commodity prices

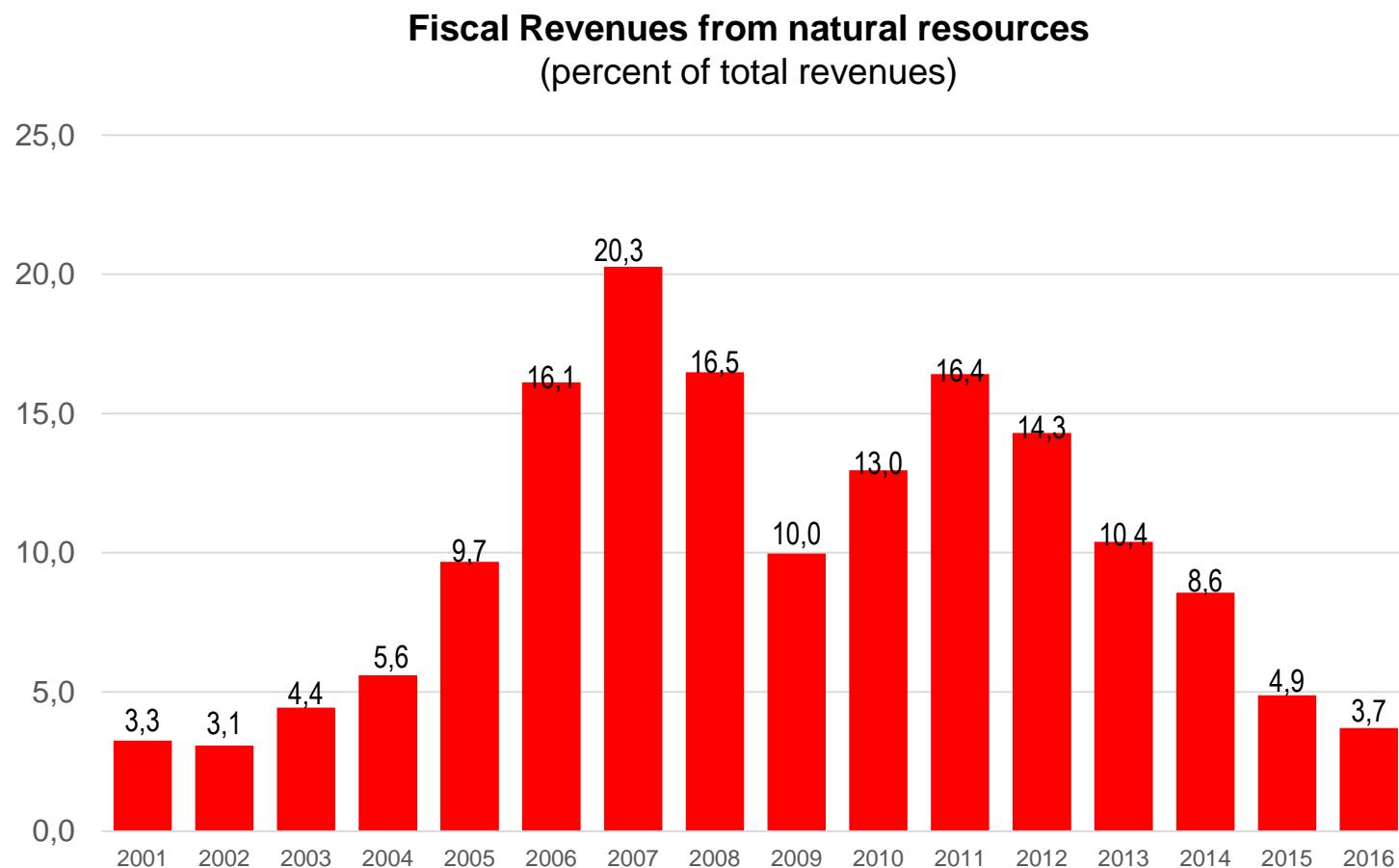
Export Price Index yoy growth rate and volatility



Nota: IPX stands for Export Price Index. Volatility is computed as the 12 months standard deviation.

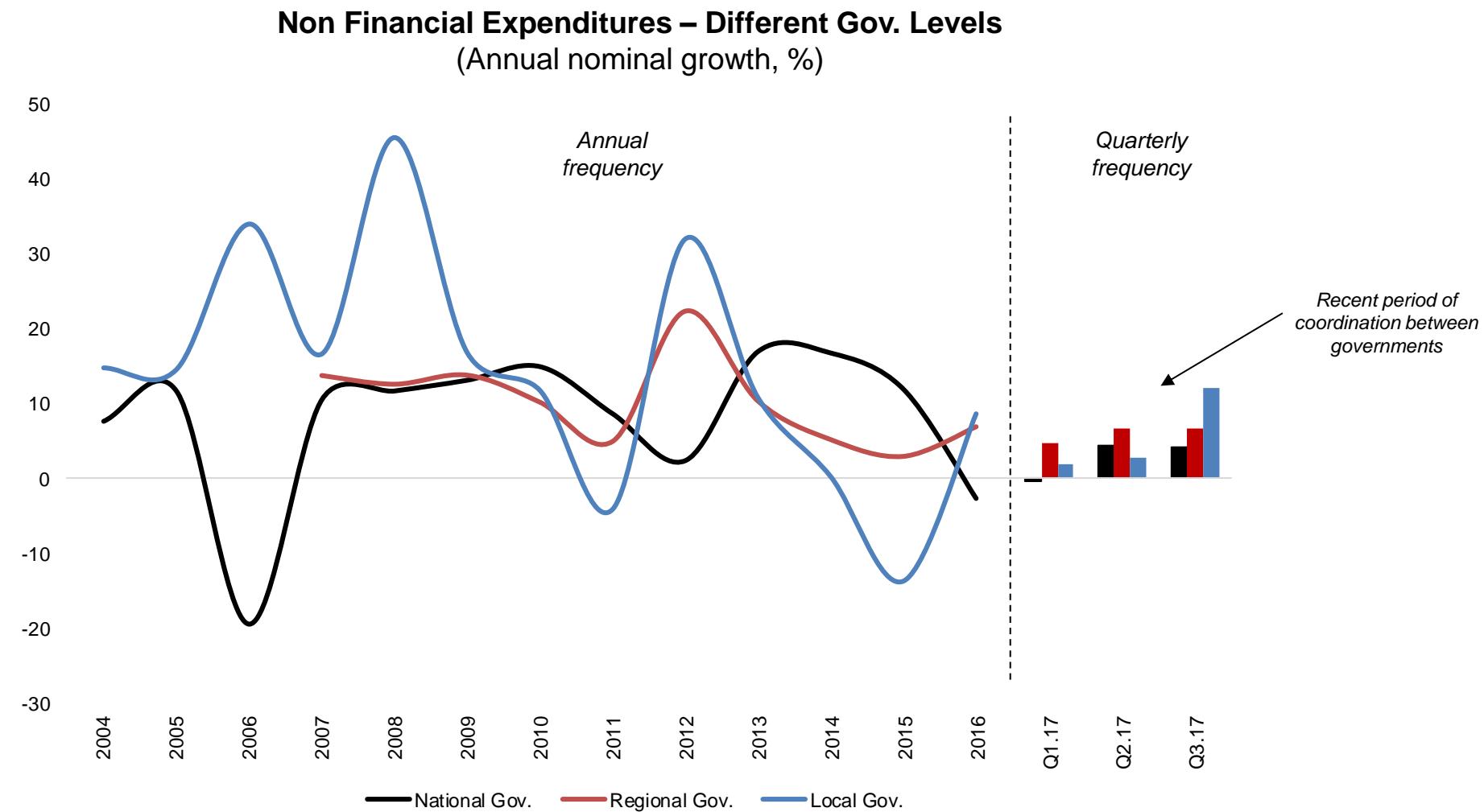
Source: Central Bank. Elaboration: Fiscal Council of Peru.

Dependence of Natural Resource revenues



Source: MEF and Fiscal Council.

Decentralization and uncoordinated public expenditures



Which are the challenges for the Fiscal Council?

- **Open or close communications.** Should we tell our opinion to the Finance Ministry openly or (first) behind closed doors.
- **Explicit or Implicit mandate.** Should we voice out our opinion when Congress or the Executive propose a fiscally irresponsible project? Or do we limit ourselves to our explicit mandate.

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