Fiscal Policy beyond fiscal rules:
Effective tax coordination and employment targeting

Input to the 1st TUAREConference

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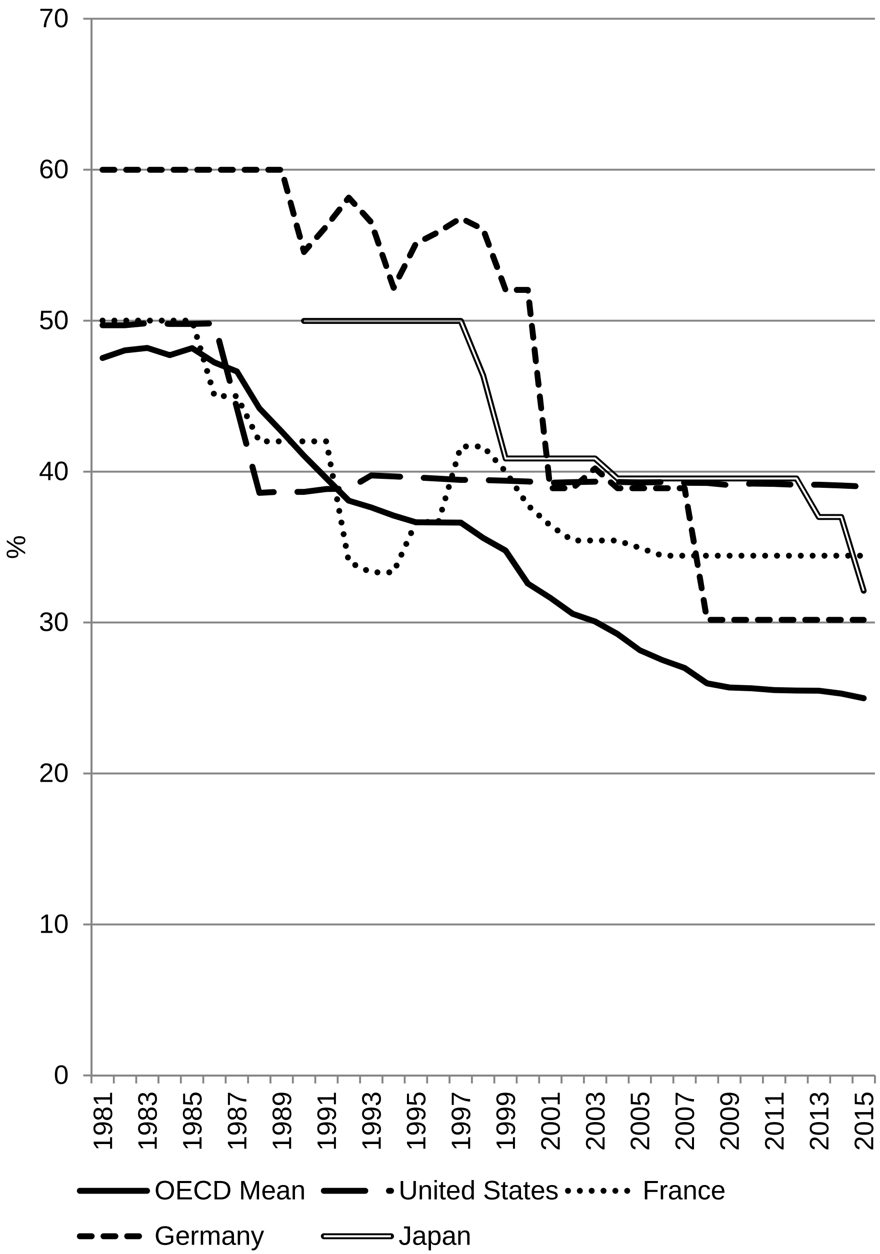
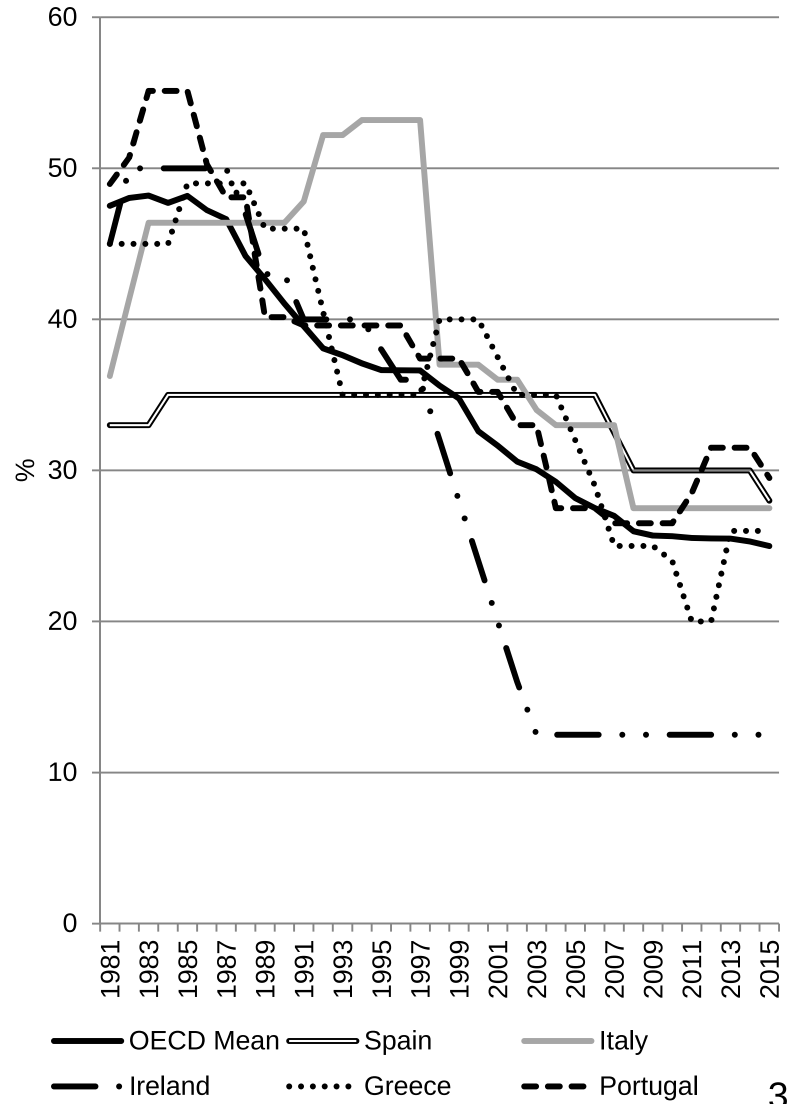
Overview

- brief reminder: how not to do it
- the problem with ambitious “optimal“institutionalised solutions
- instead: directions for improvement
- how to get started: pragmatic ways forward within the current institutional framework
- outlook: pessimism or optimism?

Nominal Corporate Income Tax Rates 1981-2015





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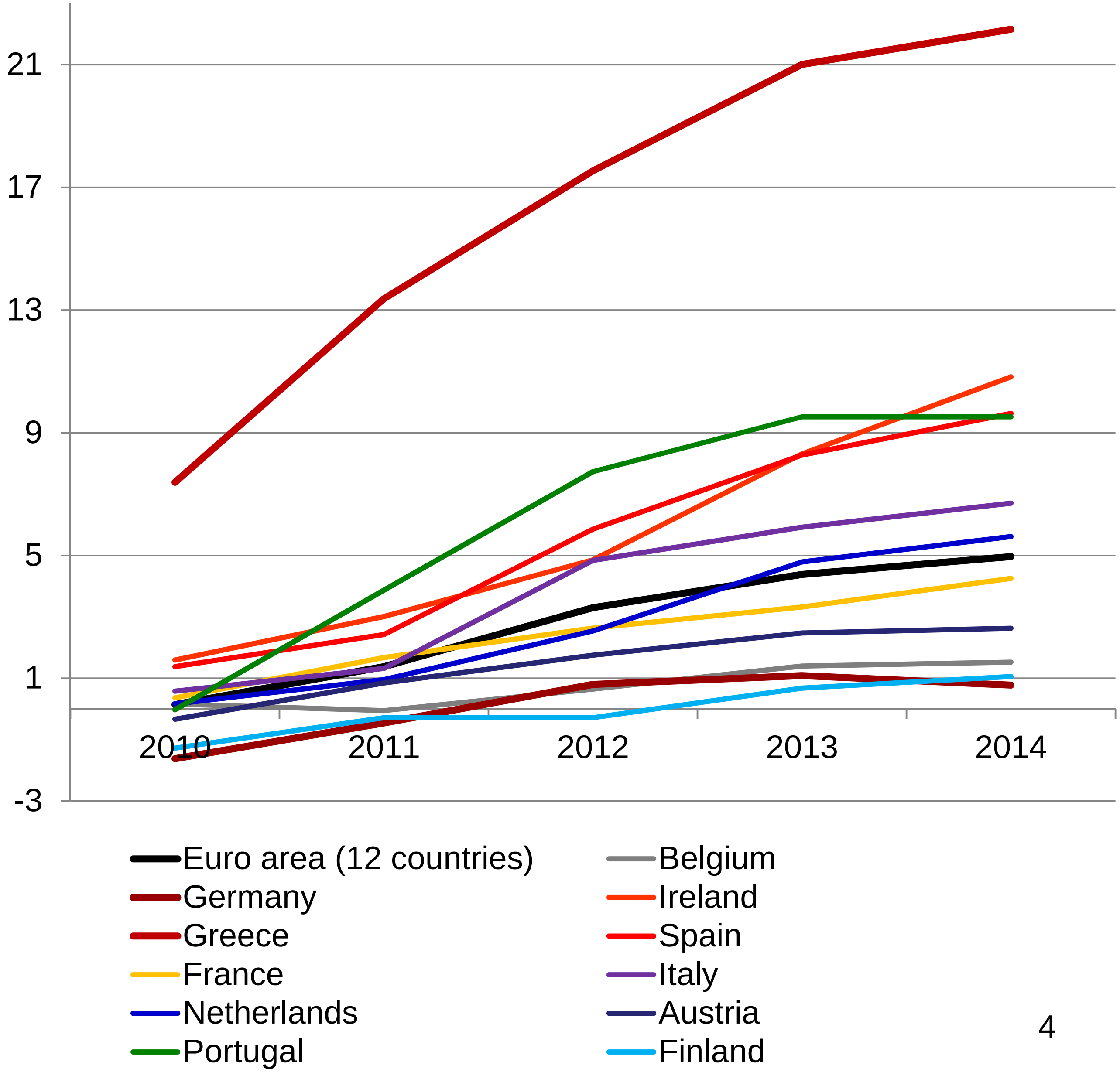
The incredible degree of austerity

‚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).



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…the neglect of (net!) public investment

cumulative net public investment cuts in relation to consolidation volume in %	2010	2011	2012	2013	2014	2015
Euro area (12 countr	182	**40**	**24**	**20**	**20**	**20**
Belgium	23	-	-11	3	1	-1
Germany	-	-	10	10	23	100
Ireland	**21**	**43**	**33**	**22**	**16**	**11**
Greece	**31**	**27**	**21**	**13**	**10**	**11**
Spain	**41**	**67**	**51**	**40**	**35**	**33**
France	30	20	11	11	15	16
Italy	90	46	19	19	19	16
Luxembourg	-	27	23	38	34	36
Netherlands	135	40	27	17	16	13
Austria	-	39	25	13	14	13
Portugal	-	**22**	**26**	**24**	**24**	**27**
Finland	-	-	-	2	3	9

source: EU Commission ameco database February 2016; author's calculations

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ambitious “optimal“ institutionalised solutions?

- comprehensive tax harmonisation as a prerequisite?
- fiscal federalism in EU with a strong federal level?
- refined system of fiscal equalisation?

But:

- is it really necessary?
- do we have to implement everything in constitutional rules?
- what about interdependence with wages and monetary policies and macroeconomic imbalances and industrial policy?
- are there political risks of capture by the neoliberals?
- how do we realistically get there?

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Directions for improvement

- **expansionary fiscal policy stance EU wide**
- **more countercyclical stabilisation**
  - more flexibility for national fiscal policies (combined with ECB support or debt relief)
    - Golden Rule of public investment
    - expenditure paths for non-cyclical spending
    - EU parliament participation in SGP decisions
    - abolish SGP?
  - more EU-wide automatic stabilisers („fiscal capacity“, unemployment insurance, EU budget)
  - But not substitution between the two!
- **Less rules and more macroeconomic policy coordination**
  - Upgrading of macroeconomic dialogue

Directions for improvement

- **more rigorous fight against tax evasion**
- **more tax harmonisation**
  - give up principle of unanimity
  - Unified tax base for corporate taxation
  - Minimum tax rates
- **Financial transaction tax**

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8 ways to boost fiscal policy and strengthen public investment

short term (use interpretational leeway within present framework to come close to the golden rule of public investment)	
strengthening investment **+** **expansionary overall fiscal policy stance**	(1) more active use of the 'investment clause'
	(2) allow for temporary investment programmes (analogous to EFSI)
	(3) interpret temporary investment programmes as structural reforms
	(4) incorporate realistic investment multiplier in budgetary analysis ex ante
	(5) use leeway in economically bad times
	(6) implement better methods of cyclical adjustment
	(7) temporarily higher spending with a view to Europe 2020 goals
	(8) use exception for severe downturn in EU or Euro area

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

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WORKING PAPER

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THE GOLDEN RULE OF PUBLIC INVESTMENT – A NECESSARY AND SUFFICIENT REFORM OF THE EU FISCAL FRAMEWORK?

Achim Truger*

Abstract

It is by now a widely shared insight that fiscal policy needs to be re-strengthened as a macroeconomic policy instrument within European macroeconomic policies: Recent experiences with austerity policies, new research regarding the size of the fiscal multiplier and the fact that monetary policy is obviously overstrained have led to this conclusion. As a consequence, increases in public investment are particularly necessary. Against this background this contribution discusses and proposes the introduction of the traditional public finance golden rule into the EU/Eurozone fiscal framework (Stability and growth pact (SGP), Fiscal Compact (FC)). Such a rule would exempt public (net) investment suitably defined from the relevant deficit targets of both the preventive and the corrective arm of the SGP as well as the FC. That way, fiscal policy would be upgraded and receive larger room for manoeuvre and public investment as a particularly growth enhancing public expenditure category would be strengthened. Different definitions are discussed and a pragmatic definition based on the national accounts with some modifications is proposed. The standard reservations against a golden rule are critically assessed, but mostly discarded. However, the potential limits of the golden rule are examined by way of pragmatic multiplier-based macroeconomic assessments: Would a golden rule have prevented the austerity crisis since 2010? Would other expenditure categories – particularly spending on social policy – have necessarily suffered? Would a golden rule leave sufficient fiscal leeway for expansionary fiscal policy in the current situation? The results are encouraging, yet they show, that the golden rule alone would not be sufficient to stabilise the Euro area economies.

JEL classification: E22, E61, E62, E65, H54, H62

Keywords: Golden rule, public investment, fiscal policy, austerity, Euro area

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Thank you very much for your attention!