

**FOR  
INFORMATION**

FO/DIS/20/196

October 5, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **U.S. Government Accountability Office—Completion of the Review of Fiscal Rules and Targets**

Board Action:

Executive Directors' **information**

Additional Information

The attached memorandum from the Managing Director notifies Executive Directors of the U.S. Government Accountability Office's (GAO) completion of the review of fiscal rules and targets. As per the Managing Director's communication to the Board on October 10, 2019 (EBD/19/41), the U.S. GAO asked the Fund to assist in this review. The cooperation was carried out in accordance with the procedures established in Decision No. 12424-(01/13). The published report is now being circulated to the Executive Board for information.

Questions:

Ms. Velculescu, SPR (ext. 37728)  
Mr. Wu, SPR (ext. 35334)





# OFFICE MEMORANDUM

To: The Members of the Executive Board

October 5, 2020

From: The Managing Director

Subject: **U.S. Government Accountability Office—Completion of the Review of Fiscal Rules and Targets**

As per the notification circulated to the Executive Board on October 10, 2019, the U.S. Government Accountability Office (GAO) requested the Fund's cooperation for their review of fiscal rules and targets for the United States. The GAO has recently published their report, which I hereby circulate for information. Fund staff was interviewed and was also given the opportunity to review the draft report before its publication to ascertain that no confidential information is disclosed and factual information is accurate. This cooperation required staff resources of about 52 person hours between late-2019 and mid-2020.

Attachments



# *Office Memorandum*

To: The Members of the Executive Board

October 10, 2019

From: The Managing Director

Subject: **U.S. Government Accountability Office—Request for Cooperation on the Reviews of Fiscal Targets**

As noted in the attached memorandum from Mr. Rosen, the U.S. Government Accountability Office (GAO) is conducting a review of fiscal targets in the process to establish potential fiscal policy options for the United States. The U.S. GAO has asked to engage with Fund staff. The terms of reference are attached to Mr. Rosen's memorandum.

Mr. Rosen's memorandum indicates that the engagement will follow the principles set out in the Executive Board Decision on Procedures for Cooperation with Investigations on Fund Activities by Auditing Institution of Members (Decision No. 12424-01/13), along with the Operational Guidelines for Cooperation with Fund Activities. The procedures limit the types of documents and information that can be provided and provide certain safeguards

The U.S. GAO will provide management and staff opportunities to review the draft report to ascertain that no confidential information is disclosed, and that factual information is correct. Management also has an option to include in full the written official comments in the published report. Once the report is published, it will be circulated promptly to the Executive Board, together with an assessment of the staff resources used by the Fund.

According to the procedure on cooperation, Executive Directors are to be notified of all request at least two weeks before the commencement of any such cooperation with the relevant agency and should have an opportunity to comment on all aspects of the notification. My intention is to approve the U.S. GAO's request for cooperation, taking into account any comments that Executive Directors may provide.

Attachment



# *Office Memorandum*

To: Mr. Mühleisen

September 9, 2019

From: Mr. Rosen /s

**Subject: Notification of U.S. Government Accountability Office Review: Fiscal Targets**

The United States Government Accountability Office (GAO) is conducting an engagement on fiscal targets, examining the use of fiscal targets and rules by other countries and the potential fiscal policy options for the United States. The review is being carried out at the request of Senator Mike Enzi, the chairman of the Senate Budget Committee. The GAO seeks to interview IMF staff to determine the types of fiscal rules and targets used by countries and factors the United States should consider if it were to design a fiscal rule. In conjunction with this review, an inquiry has been made to my office for assistance in identifying and notifying appropriate IMF officials and arranging meetings deemed necessary to carry out this review.

In line with the Executive Board Decision on Procedures for Cooperation with Investigations on Fund Activities by Auditing Agencies of Members (Decision No. 12424-(01/13), attached are the Terms of Reference for the inquiry, as provided by the GAO. In this context, the GAO has confirmed to me that:

- The GAO seeks to obtain documents which are publicly available, or not publicly available but provided to the Executive Board. Any document provided by Fund management and staff, and designated by the IMF as "confidential" or any other confidential information, including views expressed by Fund management and staff in discussing confidential documents, shall not be disclosed to any persons outside the GAO unless the express authorization of the Managing Director is granted. GAO policy and applicable statutory and regulatory requirements obligate the GAO to give the information the same level of confidentiality as the IMF. The GAO agrees that the designation of documents or information as "confidential" shall be made by the Fund and that the GAO will not dispute such designation.
- In cases where the GAO receives any document provided by Fund management and staff and designated by the IMF as "confidential," or where Fund management or staff provided other confidential information, including views expressed in discussing confidential documents, Fund management and staff will have two opportunities to review relevant sections of the draft GAO report, the first of which occurs before the

report is circulated outside the GAO. At the first stage, Fund management and staff will check relevant sections of the report for confidential information. At this stage,

Fund management and staff can also identify factual corrections. The GAO will delete any confidential information and undertake to correct factual mistakes before the draft report is circulation for official comments.

- Fund management and staff will have a second opportunity to review the draft GAO report when it is circulated for official comment. The GAO will reflect the views of Fund management and staff by, *inter alia*, including in full the final written official comments of the IMF in the published version of the report.

We understand that if Fund management concludes that the views of the Fund have not been adequately reflected in the published report, Fund management may decide to communicate those views directly to the recipients of the report.

If you have any questions or concerns during the course of this review, please contact Patricia Pollard in my office.

Attachment: GAO Terms of Reference

cc: Acting Managing Director  
Deputy Managing Directors  
Heads of Departments: LEG, SEC, FAD, WHD



September 2020

# THE NATION'S FISCAL HEALTH

## Effective Use of Fiscal Rules and Targets

# GAO Highlights

Highlights of [GAO-20-561](#), a report to congressional requesters

## Why GAO Did This Study

Our nation faces serious challenges at a time when the federal government is highly leveraged in debt by historical norms. The imbalance between revenue and spending built into current law and policy have placed the nation on an unsustainable long-term fiscal path. Fiscal rules and targets can be used to help frame and control the overall results of spending and revenue decisions that affect the debt.

GAO was asked to review fiscal rules and targets. This report (1) assesses the extent to which the federal government has taken action to contribute to long-term fiscal sustainability through fiscal rules and targets, and (2) identifies key considerations for designing, implementing, and enforcing fiscal rules and targets in the U.S.

GAO compared current and former U.S. fiscal rules to literature on the effective use of rules and targets; reviewed CBO reports and relevant laws; and interviewed experts. GAO conducted case studies of national fiscal rules in Australia, Germany, and the Netherlands.

## What GAO Recommends

Congress should consider establishing a long-term fiscal plan that includes fiscal rules and targets, such as a debt-to-GDP target, and weigh GAO's key considerations to ensure proper design, implementation, and enforcement of these rules and targets.

The Department of the Treasury and other entities provided technical comments, which GAO incorporated as appropriate.

View [GAO-20-561](#). For more information, contact Jeff Arkin, at (202) 512-6806 or [arkinj@gao.gov](mailto:arkinj@gao.gov)

September 2020

## THE NATION'S FISCAL HEALTH

### Effective Use of Fiscal Rules and Targets

## What GAO Found

In fiscal year 2019, debt held by the public reached 79 percent of gross domestic product (GDP). The government's fiscal response to COVID-19 combined with the severe economic contraction from the pandemic will substantially increase federal debt. The Congressional Budget Office (CBO) projected that debt held by the public will reach 98 percent of GDP by the end of fiscal year 2020. The nation's fiscal challenges will require attention once the economy has substantially recovered and public health goals have been attained.

GAO has previously reported that a long-term plan is needed to put the government on a sustainable fiscal path. Other countries have used well-designed fiscal rules and targets—which constrain fiscal policy by controlling factors like expenditures or revenue—to contain excessive deficits. For example, Germany's constitution places limits on its deficits. The U.S. federal government has previously enacted fiscal rules, such as those in the Budget Control Act of 2011. However, current fiscal rules have not effectively addressed the misalignment between spending and revenues over time.

GAO identified key considerations to help Congress if it were to adopt new fiscal rules and targets, as part of a long-term plan for fiscal sustainability (see table).

#### Key Considerations for Designing, Implementing, and Enforcing Fiscal Rules and Targets

Alignment with Fiscal Policy Goals and Objectives



Setting clear goals and objectives can anchor a country's fiscal policy. Fiscal rules and targets can help ensure that spending and revenue decisions align with agreed-upon goals and objectives.

Design Tradeoffs and Features



The weight given to tradeoffs among simplicity, flexibility, and enforceability depends on the goals a country is trying to achieve with a fiscal rule. In addition, there are tradeoffs between the types and combinations of rules, and the time frames over which the rules apply.

Legal Framework and Permanence



The degree to which fiscal rules and targets are binding, such as being supported through a country's constitution or nonbinding political agreements, can impact their permanence, as well as the extent to which ongoing political commitment is needed to uphold them.

Integration with Budgetary Processes



Integrating fiscal rules and targets into budget discussions can contribute to their ongoing use and provide for a built-in enforcement mechanism. The budget process can include reviews of fiscal rules and targets.

Flexibility to Address Emerging Issues



Fiscal rules and targets with limited, well-defined exemptions, clear escape clauses for events such as national emergencies, and adjustments for the economic cycle can help a country address future crises.

Clear Roles for Supporting Institutions



Institutions supporting fiscal rules and targets need clear roles and responsibilities for supporting their implementation and measuring their effectiveness. Independently analyzed data and assessments can help institutions monitor compliance with fiscal rules and targets.

Transparency and Communication



Having clear, transparent fiscal rules and targets that a government communicates to the public and that the public understands can contribute to a culture of fiscal transparency and promote fiscal sustainability for the country.

Source: GAO analysis of literature review and interviews. | GAO-20-561

United States Government Accountability Office



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## Abbreviations

BBEDCA	Balanced Budget and Emergency Deficit Control Act of 1985
Basic Law	Constitution for the Federal Republic of Germany
BCA	Budget Control Act of 2011
BEA	Budget Enforcement Act of 1990
CBO	Congressional Budget Office
Charter	Charter of Budget Honesty Act 1998
COVID-19	Coronavirus Disease 2019
EU	European Union
GDP	gross domestic product
IMF	International Monetary Fund
Joint Committee	Joint Select Committee on Deficit Reduction
OECD	Organization for Economic Co-operation and Development
OMB	Office of Management and Budget
PAYGO	Pay-As-You-Go
SGP	Stability and Growth Pact
Statutory PAYGO Act	Statutory Pay-As-You-Go Act of 2010
Treasury	Department of the Treasury

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September 23, 2020

The Honorable Mike Enzi  
Chairman  
Committee on the Budget  
United States Senate

The Honorable Steve Womack  
Ranking Member  
Committee on the Budget  
House of Representatives

Our nation faces serious economic, security, and social challenges at a time when the federal government is highly leveraged in debt by historical norms and is on an unsustainable long-term fiscal path. Federal debt is rising due to an imbalance between spending and revenue that is built into current law and policy. From fiscal year 2001—the last year in which the federal government ran a budget surplus—to fiscal year 2019, debt held by the public increased from \$3.3 trillion to \$16.8 trillion, or from about 32 percent of gross domestic product (GDP) to 79 percent.<sup>1</sup>

The long-term fiscal challenges facing the United States have been exacerbated by the Coronavirus Disease 2019 (COVID-19) pandemic. In response to this unprecedented global crisis, Congress and the administration have taken a series of actions to protect the health and well-being of Americans. The federal government's fiscal response to the COVID-19 pandemic combined with the severe economic contraction from the pandemic have generated a substantial increase in federal debt and are expected to continue to do so, as expenditures increase and tax revenues fall.

In September 2020, the Congressional Budget Office (CBO) projected that the federal deficit for fiscal year 2020 will reach \$3.3 trillion and debt held by the public would reach 98 percent of GDP by the end of fiscal year 2020. By the end of fiscal year 2023, CBO projects that debt held by

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<sup>1</sup>Debt held by the public is the amount of money that the federal government owes to its investors. Intragovernmental debt is the amount of money the federal government owes to itself. Together, that debt is called total federal debt. Total federal debt rose to \$22.8 trillion during fiscal year 2019, an increase of about \$1.2 trillion from fiscal year 2018. Debt held by the public increased from about \$15.8 trillion to \$16.8 trillion, and intragovernmental debt increased from about \$5.8 trillion to \$6 trillion.

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the public will reach 107 percent of GDP, the highest percentage in the nation's history.

These fiscal challenges will require attention once the economy has substantially recovered and public health goals have been attained. In our prior work on the Nation's Fiscal Health, we stated that the federal government needs to have a long-term plan to help put it on a sustainable fiscal path.<sup>2</sup> As part of this plan, fiscal rules and targets can be used to help frame and control the overall results of spending and revenue decisions. Fiscal rules can support efforts to achieve fiscal sustainability by imposing numerical limits on the budget to guide fiscal policy. Fiscal targets can be used to set interim goals within the parameters set by fiscal rules. These rules and targets can also be designed to support economic growth by accommodating fiscal policy responses to changing economic conditions and national emergencies, such as COVID-19.

You asked us to review issues related to fiscal rules and targets, including other countries' experiences. This report (1) assesses the extent to which the federal government has taken action to contribute to long-term fiscal sustainability through fiscal rules and targets, and (2) identifies key considerations for designing, implementing, and enforcing fiscal rules and targets in the United States.

To address our first objective, we analyzed the federal government's fiscal condition by reviewing CBO reports and our prior work on the Nation's Fiscal Health.<sup>3</sup> We evaluated current and former federal fiscal rules and targets by reviewing relevant laws and interviewing experts on federal fiscal policy.<sup>4</sup> We compared prior and current federal fiscal rules and targets to literature on the effective use of fiscal rules and targets to control the federal government's and other countries' deficits and debt,

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<sup>2</sup>See GAO, *The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future*, [GAO-20-403SP](#) (Washington, D.C.: Mar. 12, 2020), and *The Nation's Fiscal Health: Actions Needed to Achieve Long-Term Fiscal Sustainability*, [GAO-19-611T](#) (Washington, D.C.: June 26, 2019).

<sup>3</sup>[GAO-20-403SP](#), [GAO-19-611T](#), and *The Nation's Fiscal Health: Action is Needed to Address the Federal Government's Fiscal Future*, [GAO-19-314SP](#) (Washington, D.C.: Apr. 10, 2019).

<sup>4</sup>Specifically, we analyzed: Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, 99 Stat. 1037 (1985), Budget Enforcement Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-1 (1990), Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139, 124 Stat. 8 (2010), and Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 240 (2011).

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including International Monetary Fund (IMF) and Organization for Economic Co-Operation and Development (OECD) reports.

To address our second objective and provide examples from other countries' experiences, we reviewed and systematically analyzed literature on the use of fiscal rules and targets by other OECD-member countries. We also interviewed experts on budgetary processes, federal fiscal policy, and fiscal rules and targets. We evaluated and synthesized information from the literature review and interviews to identify commonly-reported key considerations.

We conducted case studies of selected countries to identify illustrative examples of how other countries have used fiscal rules and targets to help successfully manage their long-term fiscal challenges. These examples illustrate how the key considerations we identified have worked well in other countries. For these case studies, we selected Australia, Germany, and the Netherlands based on (1) their membership in the OECD, (2) evidence that their fiscal rules have been effective, and (3) the diversity of their fiscal rules. Collectively, these cases studies represent a variety of types of rules, legal basis for those rules (such as constitutional or statutory rules), and institutions and enforcement mechanisms to support those rules. Detailed information on our scope and methodology is included in appendix I.

We conducted this performance audit from February 2019 to September 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

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### Federal Fiscal Condition

As we have previously reported, the federal government is on an unsustainable long-term fiscal path caused by an imbalance between

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revenue and spending that is built into current law and policy.<sup>5</sup> This imbalance has contributed to the growing debt. For most of the nation's history, the debt-to-GDP ratio has increased during wartime and recessions and decreased during peacetime and economic expansions (see figure 1).<sup>6</sup> Publicly held debt as a share of GDP peaked at 106 percent just after World War II (in 1946) but then fell rapidly. However, beginning in the 1970s, U.S. debt held by the public has generally grown steadily as a share of GDP, including during three of the four most recent economic expansions.<sup>7</sup> By the end of fiscal year 2019, debt had climbed to 79 percent of GDP. By comparison, debt has averaged 46 percent of GDP from 1946 through 2019.

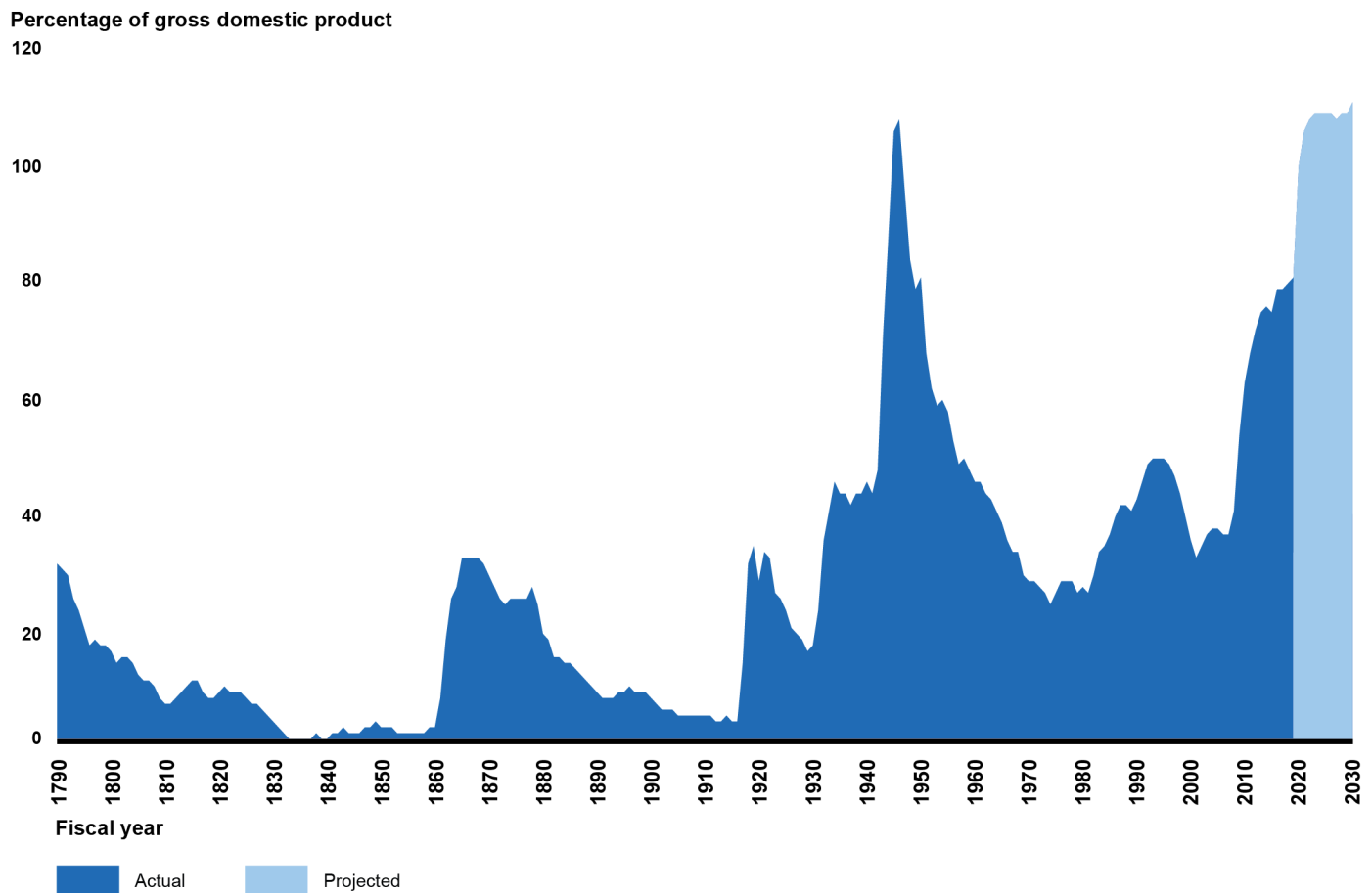
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<sup>5</sup>Simulations by GAO and others show that, over the long term, the structural imbalance between spending and revenue that is built into current law and policy means that the deficit and debt held by the public is expected to grow as a share of GDP. For more information, see [GAO-20-403SP](#).

<sup>6</sup>GDP is the value of all goods and services produced within the borders of a country in a given period. The dollar value of debt is difficult to interpret absent some sense of the size of the economy supporting it. Therefore, the ratio of debt to GDP is used to gauge a country's ability to pay its debt.

<sup>7</sup>According to the National Bureau of Economic Research, a recession begins when the economy reaches a peak of activity and ends when the economy reaches its trough. Between trough and peak, the economy is in an expansion.

**Figure 1: Federal Debt Held by the Public**



Source: GAO analysis of Congressional Budget Office data. | GAO-20-561

Rising debt is caused by a misalignment between spending and revenues over time. For example, while both spending and revenue have increased in the past three fiscal years, growth in spending has outweighed modest revenue growth, deepening the fiscal imbalance (see table 1).

**Table 1: Receipts, Spending, and Deficit for Fiscal Years 2017-2019**

Dollars in billions

	Fiscal year 2017	Fiscal year 2018	Fiscal year 2019
Receipts (revenues)	3,315	3,329	3,462
Outlays (spending)	(3,981)	(4,108)	(4,447)
Deficit	(666)	(779)	(984)

Source: Financial Reports of the United States Government. | GAO-20-561

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Long-term fiscal projections show that, absent policy changes, the federal government continues to face an unsustainable long-term fiscal path. In March 2020, prior to the fiscal and economic effects of COVID-19, we projected that debt as a share of GDP in 2050 would be nearly twice its historical high (reached in 1946) and about four times its post-World War II average.<sup>8</sup>

The federal government's fiscal outlook has further deteriorated in light of COVID-19. In response to this unprecedented global crisis, four relief laws were enacted as of June 2020 that appropriated \$2.6 trillion across the government to fund response and recovery efforts, as well as to mitigate the public health, economic, and homeland security effects of COVID-19.<sup>9</sup>

In addition, COVID-19 is expected to negatively affect the nation's GDP and tax revenue. In July 2020, CBO estimated that real (inflation-adjusted) GDP will contract by 3.8 percent in fiscal year 2020. Revenues are also expected to be sharply lower in 2020 than in 2019. In September 2020, CBO estimated that revenues for fiscal year 2020 will be about \$3.3 trillion, or \$167 billion less than fiscal year 2019.<sup>10</sup> As a result, the federal government's projected deficit and debt for the end of fiscal year 2020 have worsened substantially (see table 2).

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<sup>8</sup>[GAO-20-403SP](#).

<sup>9</sup>The four relief laws are the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, Pub. L. No. 116-123, 134 Stat. 146 (2020); Families First Coronavirus Response Act, Pub. L. No. 116-127, 134 Stat. 178 (2020); Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, 134 Stat. 281 (2020); and Paycheck Protection Program and Health Care Enhancement Act, Pub. L. No. 116-139, 134 Stat. 620 (2020).

<sup>10</sup>Falling incomes and lower spending will reduce tax revenues to state and local governments as well, while heightened demands on state-supported social programs are likely to increase state and local expenditures. State and local governments already faced a range of fiscal challenges and pressures prior to the pandemic. See GAO, *Intergovernmental Issues: Key Trends and Issues Regarding State and Local Sector Finances*, [GAO-20-437](#) (Washington, D.C.: Mar. 23, 2020), and *State and Local Governments' Fiscal Outlook: 2019 Update*, [GAO-20-269SP](#) (Washington, D.C.: Dec. 19, 2019).



**Table 2: Deficit and Debt Projections for the End of Fiscal Year 2020**

	January 2020 projections		September 2020 projections	
	Dollars, in trillions	Percentage of gross domestic product <sup>a</sup>	Dollars, in trillions	Percentage of gross domestic product
Federal budget deficit, end of fiscal year 2020	1	4.6	3.3	16.0
Federal debt held by the public, end of fiscal year 2020	17.9	81	20.3	98

Source: GAO analysis of Congressional Budget Office information. | GAO-20-561

Note: These projections for the end of fiscal year 2020 were published in January and September, respectively.

<sup>a</sup>In January 2020 CBO projected that gross domestic product for the fiscal year would be \$22.1 trillion. In September 2020 CBO revised this projection to \$20.6 trillion.

At a time when the federal government’s ability to fiscally respond to COVID-19 is crucial, the high level of federal debt that existed prior to the pandemic is continuing to strain the federal budget. In the aftermath of COVID-19, more drastic fiscal policy changes will be needed to ensure that policymakers can continue to address national priorities, such as national security, the nation’s infrastructure, and promoting economic growth. We have previously reported that, to change the long-term fiscal path, policymakers will need to consider policy changes to the entire range of federal activities: revenue (including tax expenditures) and spending (including entitlement programs, other mandatory spending, and discretionary spending).<sup>11</sup>

## Federal Debt Limit

The federal debt limit is a legal limit on the total amount of federal debt that can be outstanding at one time. <sup>12</sup> It is not a fiscal rule because it only restricts the Department of the Treasury’s (Treasury) authority to borrow and finance the decisions already passed by Congress and signed into law by the President; it does not restrict Congress’s ability to pass

<sup>11</sup>[GAO-20-403SP](#). Tax expenditures are provisions of the tax code that reduce taxpayers’ tax liability and therefore the amount of tax revenue paid to the government. Examples include tax credits, deductions, exclusions, exemptions, deferrals, and preferential tax rates.

<sup>12</sup>The debt limit is codified at 31 USC § 3101(b), as amended, and applies to federal debt issued pursuant to authority under 31 U.S.C. chapter 31. However, the debt limit was suspended and is scheduled for reinstatement on August 1, 2021, with the debt limit increased to the amount of obligations outstanding on that date. Bipartisan Budget Act of 2019, Pub. L. No. 116-37, § 301, 133 Stat. 1049 (2019), *codified at* 31 U.S.C. § 3101 note.

spending and revenue legislation that affects the level of debt. Without legislation to suspend or raise the debt limit, Treasury cannot continue issuing debt to finance the decisions already passed by Congress and signed into law by the President.

Overview of Fiscal Rules

According to the IMF, a fiscal rule is a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates, such as expenditures or revenue. Fiscal targets are the interim benchmarks that may be established within the parameters set by the fiscal rules. They have been used at both the national level in the United States and other countries, as well as at the supranational level, such as in the European Union’s (EU) member states, to help promote fiscal responsibility and sustainability. According to the IMF and OECD, several types of fiscal rules have the potential to contribute to fiscal sustainability (see table 3). Governments can also use a combination of different fiscal rules to address shortcomings of any one individual rule.

Table 3: Types of Fiscal Rules	
Type of rule	Description
Budget balance rule	Constrains deficit levels or targets a budget surplus.
Debt rule	Sets an explicit limit or target for debt held by the public, typically as a share of gross domestic product.
Revenue rule	Sets ceilings or floors on revenues and aims to increase revenue collection or prevent excessive tax burdens.
Expenditure rule	Limits spending, typically in absolute terms or growth rates and, occasionally, as a percentage of gross domestic product.

Source: GAO analysis of the Organization for Economic Co-operation and Development and International Monetary Fund reports. | GAO-20-561

According to the IMF, there are several types of budget balance rules, which define and target the budget deficit or surplus in various ways:

- **Overall balance rules.** These rules target the difference between total spending and revenues, without the adjustments that can be found in the other types of budget balance rules listed below.
- **Primary balance rules.** These rules target the difference between noninterest spending and revenues, excluding interest payments made on existing debt.

- **Golden rules.** These rules target the difference between noninvestment spending and revenue, known as the current balance.<sup>13</sup>
- **Cyclically-adjusted balance rules.** These rules correct for the effects of economic fluctuations by setting a target based on what the budget balance would be if the economy were operating at its full potential.
- **Structural balance rules.** These rules are similar to cyclically-adjusted balance rules. In addition to correcting for economic fluctuations, they exclude large, nonrecurring fiscal measures, such as one-time revenue windfalls or large expenditures such as emergency relief after a natural disaster.

## Fiscal Rules in Other Countries

Various countries have used fiscal rules at the local, national, and supranational (e.g., the EU) level to address their long-term fiscal sustainability. According to the IMF, as of 2016 more than 90 countries were using fiscal rules. National fiscal rules for our three selected case study countries are shown in table 4.<sup>14</sup>

**Table 4: National Fiscal Rules in Australia, Germany, and the Netherlands**

Country	Summary of national fiscal rules
Australia	Australia maintains a principles-based framework approach for fiscal management. The Charter of Budget Honesty Act 1998 (Charter) outlines five principles for fiscal management, such as prudent management of debt and fiscal risks, and requires the government to outline a fiscal strategy that includes objectives and priorities for fiscal policy. The fiscal strategy may include fiscal rules that focus on revenues, expenditures, the budget balance, and debt. The Charter specifies when and how the government develops and reports on its fiscal strategy, consistent with those principles. <sup>a</sup>
Germany	In 2009, Germany enacted a constitutionally-mandated structural budget balance target, which requires federal structural net borrowing of no more than 0.35 percent of GDP. <sup>b</sup> In addition, in 2018, the German government reinforced a commitment to maintain no annual deficits.
The Netherlands	The Netherlands has expenditure and revenue rules and targets, which are political commitments adopted by a new government after elections. These targets establish a framework that lasts for the government's 4-year term.

Source: GAO analysis of government documents and applicable laws from Australia, Germany, and the Netherlands. | GAO-20-561

<sup>a</sup>Charter of Budget Honesty Act 1998, sch. 1, pt. 3.

<sup>13</sup>Investment expenditures are those that enhance long-term economic productivity, such as infrastructure or research and development. However, it can be difficult to clearly define which expenditures are "investments."

<sup>14</sup>See appendix II for a more detailed discussion of fiscal rules in Australia, Germany, and the Netherlands.

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<sup>b</sup>Germany's structural budget balance target accounts for the impact of the economic cycle on the federal government's revenues and expenditures. Basic Law, art. 115(2).

The EU also has fiscal rules that apply to its member states, including Germany and the Netherlands (see text box).

**European Union Fiscal Rules**

The European Union (EU) first laid the groundwork for fiscal rules with the Maastricht Treaty in 1992, which requires EU member states to maintain overall budget deficits of less than 3 percent of GDP and debt levels of less than 60 percent of GDP. The Stability and Growth Pact of 1997 imposed further requirements, which have been amended several times by subsequent regulations. In its current form, the pact's requirements include an individual medium-term objective, updated every 3 years, for each member state's structural budget balance (i.e., corrected for economic fluctuations and nonrecurring fiscal measures).

If a member state does not meet these requirements, the EU can require specific fiscal adjustments, including annual targets for the overall and structural deficits and a time frame for correcting the member state's fiscal imbalance. Before doing so, the EU considers mitigating factors, such as the member state's fiscal and economic circumstances. Finance Ministers of EU member states also have authority to impose financial sanctions on fellow member states, but have never imposed them, as of June 2020.

In cases of a severe economic downturn or an unusual event outside the government's control, member states may be allowed to deviate from the EU's fiscal rules. In addition, the EU invoked a general escape clause on March 17, 2020, in response to the economic downturn caused by COVID-19.

Source: GAO analysis of European Union documents. | GAO-20-561

The experiences of Australia, Germany, and the Netherlands illustrate various aspects of the design, implementation, and enforcement of effective fiscal rules. However, when considering how their experiences may be used in the United States, we recognize some significant differences. First, all three countries have parliamentary systems. There may be differences between presidential and parliamentary systems that affect countries' experiences with fiscal rules. Second, there may be differences in these countries' economies that limit the applicability of their experiences to the United States. Finally, Germany's and the Netherlands' membership in the EU mean that their national governments must abide by fiscal requirements commonly agreed to at the supranational level.

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## The U.S. Lacks a Long-Term Fiscal Plan and Effective Fiscal Rules to Control the Growing Debt

We have previously reported that a long-term plan that covers the entire range of federal activities—including both revenue and spending—is needed to address the growing debt and put the government on a sustainable fiscal path.<sup>15</sup> The federal government does not have such a plan to help guide policymakers' decisions on spending and revenues over the long term.

Having a long-term plan with clear goals and objectives, as well as strategies for achieving those goals and objectives would provide transparency over the fiscal impacts of budget decisions for the year and over the long term. Our work on strategic planning has shown that a long-term plan can provide a cohesive picture of the government's long-term goals and serve as a mechanism for building consensus around these goals, as a well as a road map for achieving them.<sup>16</sup>

Fiscal rules and targets that support efforts to achieve fiscal sustainability could be included as part of this long-term plan.<sup>17</sup> The IMF has reported that well-designed fiscal rules have been effective in containing excessive deficits in other countries.<sup>18</sup> In addition, the OECD has reported that debt-to-GDP targets can serve as a fiscal policy anchor for a country's government to help ensure the sustainability of fiscal policy and maintain sufficient policy room for the government to cope with adverse shocks.<sup>19</sup>

The federal government has previously enacted fiscal rules in the form of laws that seek to constrain and enforce fiscal policy decisions (see table 5). As we have previously reported, the federal government's experience

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<sup>15</sup>[GAO-19-611T](#).

<sup>16</sup>GAO, *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results*, [GAO-04-38](#) (Washington, D.C.: Mar. 10, 2004).

<sup>17</sup>We have previously reported that Congress should also consider alternative approaches to the debt limit as part of a long-term fiscal plan. If the level of publicly held debt or its share of GDP is to be used as a fiscal management tool to change the long-term fiscal path, it needs to be considered as part of overall budget decisions at the time those decisions are being made. See [GAO-19-611T](#).

<sup>18</sup>Luc Eyraud, Xavier Debrun, Andrew Hodge, Victor Lledó, and Catherine Pattillo, *Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability*, Staff Discussion Notes No. 18/04 (International Monetary Fund, April 2018) and IMF, *Fiscal Rules—Anchoring Expectations for Sustainable Public Finances* (Dec.16, 2009).

<sup>19</sup>OECD, *Prudent Debt Targets and Fiscal Frameworks*, OECD Economic Policy Paper No. 15 (July 2015).

with these fiscal rules illustrates the challenge in designing rules that are both achievable and effective in addressing the nation's growing debt.<sup>20</sup>

**Table 5: Previously-Enacted Federal Fiscal Rules**

Law	Fiscal years in effect	Requirements	Limitations
Balanced Budget and Emergency Deficit Control Act of 1985 (BBEDCA) Pub. L. No. 99-177, 99 Stat. 1037 (1985).	1986–1993 <sup>a</sup>	Created annual deficit limits to establish a balanced budget.	Some factors that affected the deficit were not within Congress's control, such as economic or demographic changes.
Budget Enforcement Act of 1990 (BEA) Pub. L. No. 101-508, 104 Stat. 1388-1 (1990).	1991–2002	<ul style="list-style-type: none"> <li>Limited annual discretionary spending.</li> <li>Implemented a pay-as-you-go (PAYGO) rule for new direct (i.e., mandatory) spending and revenue legislation, under which the net effect of new laws could not increase the deficit in any given year.<sup>b</sup></li> </ul>	Controls on discretionary spending and new legislation did not control the growth in spending that results from previously-enacted laws, such as Medicare.
Statutory Pay-As-You-Go Act of 2010 (Statutory PAYGO Act) Pub. L. No. 111-139, 124 Stat. 8 (2010). <sup>c</sup>	2010–present (no expiration date)	Requires that the net effect of new direct spending and revenue laws cannot increase the deficit.	Like the BEA, the Statutory PAYGO Act does not control the growth in spending that results from previously enacted laws, such as Medicare. The act also does not apply to discretionary spending.
Budget Control Act of 2011 (BCA) Pub. L. No. 112-25, 125 Stat. 240 (2011).	2012–2021 for discretionary spending 2012–2030 for direct spending	<ul style="list-style-type: none"> <li>Limits annual discretionary spending.</li> <li>Required Congress to pass and the President to sign legislation on further deficit reduction. Absent such legislation, discretionary spending was further reduced and reductions in direct spending took effect.<sup>d</sup></li> </ul>	<ul style="list-style-type: none"> <li>Spending for emergencies and overseas contingency operations do not count towards discretionary spending limits.<sup>e</sup></li> <li>Subsequent laws changed the discretionary spending limits or enforcement procedures, which increased annual deficits.<sup>f</sup></li> <li>The law did not include specific reductions to direct spending; rather, it provided for automatic, across-the-board reductions in direct spending if legislation was not enacted to achieve further deficit reduction as required. Such legislation was not enacted.</li> <li>The law did not seek to control revenues.</li> <li>Congress and the President did not reach agreement on further deficit reduction as required.</li> </ul>

Source: GAO analysis of applicable laws. | GAO-20-561

<sup>20</sup>[GAO-19-611T](#).

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Note: Generally, if spending exceeds a target specified by these laws, the President is required to issue an automatic, across-the-board cancellation of budgetary resources, known as sequestration. This order would reduce budget authority by a uniform percentage in the amount necessary to reach the target. Sequestration procedures were established under BBEDCA and continue under subsequent fiscal laws.

<sup>a</sup>As enacted, BBEDCA contained a provision requiring the Comptroller General to report to the President whether revenues and outlays for the coming fiscal year would result in a deficit exceeding the maximum amount allowed under BBEDCA for that fiscal year and the budget reductions necessary to reach the prescribed deficit level. Pub. L. No. 99-177, § 251(b), 99 Stat. 1037, 1068-1069 (1985). The President was then required to order reductions in spending consistent with the Comptroller General's report. Pub. L. No. 99-177, § 252(a)(3). In 1986 the Supreme Court held this provision unconstitutional because it assigned executive powers to the Comptroller General in violation of the doctrine of separation of powers. *Bowsher v. Synar*, 478 U.S. 714 (1986). Subsequently, BBEDCA was amended by the Balanced Budget Emergency Deficit Control Reaffirmation Act of 1987. Pub. L. No. 100-119, 101 Stat. 754 (1987). Among other things, the 1987 law extended the time frame for balancing the budget to fiscal year 1993.

<sup>b</sup>Direct spending, often referred to as mandatory spending, consists of budgetary resources provided by entitlement authority and laws other than appropriations acts.

<sup>c</sup>The Senate and the House of Representatives also have PAYGO rules, which generally provide that legislation affecting direct spending or revenues may not be considered if it would increase the deficit over a given period. These rules are internal rules that are not enforceable by the Statutory PAYGO Act. They are outside the scope of our review.

<sup>d</sup>The BCA established the Joint Select Committee on Deficit Reduction (Joint Committee), which was tasked with proposing legislation to reduce the deficit by \$1.2 trillion or more through fiscal year 2021. The Joint Committee was to report its proposal by December 2, 2011, and Congress was to pass and the President was required to sign into law legislation by January 15, 2012. The Joint Committee did not report a proposal and such legislation was not enacted. This failure triggered (1) sequestration of discretionary spending in fiscal year 2013, (2) reductions to annual discretionary spending limits through fiscal year 2021, and (3) automatic, across-the-board reductions to direct spending.

<sup>e</sup>The BCA allows its spending limits to be adjusted for certain categories such as emergency appropriations and appropriations for overseas contingency operations.

<sup>f</sup>These laws include the American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013), the Bipartisan Budget Act of 2013, Pub. L. No. 113-67, 127 Stat. 1165 (2013), the Bipartisan Budget Act of 2015, Pub. L. No. 114-74, 129 Stat. 584 (2015), the Bipartisan Budget Act of 2018, Pub. L. No. 115-123, 132 Stat. 64 (2018), the Consolidated Appropriations Act of 2018, Pub. L. No. 115-141, div. O, tit. I, § 102, 132 Stat. 348, 1059 (2018), the Bipartisan Budget Act of 2019, Pub. L. No. 116-37, § 101, 133 Stat. 1049 (2019), and the Coronavirus Aid, Relief, and Economic Security Act of 2020, Pub. L. No. 116-136, § 3709(b), 134 Stat. 281 (2019).

The two fiscal rules currently in effect—the Statutory PAYGO Act and the BCA—have not corrected the imbalance between spending and revenues that has led to rising debt. From fiscal year 2012 through fiscal year 2019, when both laws were in effect, federal debt held by the public continued to grow (from 70 percent to 79 percent of GDP), even though the economy was expanding during this period.<sup>21</sup> These fiscal rules have not put the nation on a sustainable fiscal path because they were not

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<sup>21</sup>Other factors being equal, increasing GDP lowers the debt-to-GDP ratio while decreasing GDP raises this ratio.

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designed to encompass the entire range of factors that contribute to the federal government's fiscal imbalance. Specifically:

- The Statutory PAYGO Act enforces a rule of budget neutrality on new direct (or mandatory) spending and revenue legislation.<sup>22</sup> In other words, it requires that such legislation cannot increase the deficit in any given year. However, federal spending can increase in some areas as a result of programs established by previously-enacted laws, such as Medicare.
- The BCA set limits on annual discretionary spending, which constituted about 30 percent of federal outlays in fiscal year 2019. Implementation of the BCA also resulted in across-the-board reductions to direct spending.<sup>23</sup> However, in fiscal year 2019 these reductions totaled less than \$20 billion, or about 2 percent of the \$984 billion deficit for that year. In addition, the BCA addressed only the spending side of the federal government's fiscal imbalance and did not address revenues.

Likewise, Congress has passed and the President has signed numerous laws amending the BCA that have limited its effectiveness. Most of these laws increased the BCA's discretionary spending limits, which in turn increased annual deficits.

According to the Congressional Budget Office (CBO), high and rising debt could erode confidence in the U.S. dollar as an international reserve currency, crowd out private investment, and lead to expectations of higher rates of inflation.<sup>24</sup> CBO has also said that higher levels of debt increase the risk of a fiscal crisis, in which investors lose confidence in the U.S. government's financial position, potentially leading to interest rates on Treasury securities increasing abruptly. A fiscal crisis of this nature would

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<sup>22</sup>The Office of Management and Budget tracks the budgetary effects of new direct spending and revenue provisions. Specifically, these provisions are added to a rolling 5-year and 10-year "scorecard," which records the budgetary effects (i.e., costs and savings) of legislation that affects direct spending or revenue. After the congressional session ends, if the amount on either the 5-year or 10-year scorecard shows a debit for the budget year (i.e., costs that exceed savings), the President is required to order automatic across-the-board spending cuts, known as sequestration.

<sup>23</sup>Automatic, across-the-board spending reductions—known as sequestration—occur each year through 2030 under the BCA and related legislation because Congress and the President did not reach agreement on further deficit reduction as required by the law.

<sup>24</sup>CBO, *The 2019 Long-Term Budget Outlook* (Washington, D.C.: June 2019).



have further negative economic effects and could trigger a global financial crisis.

No process can force choices that policymakers are unwilling to make. In other words, Congress cannot be forced to pass and the President cannot be forced to sign into law decisions that may lead the nation towards fiscal sustainability. For this reason, among others, budget experts disagree on whether fiscal rules and targets are effective tools for controlling the deficit and debt in the United States. However, according to IMF officials, fiscal rules may be effective even if they are not strictly complied with, because they may encourage countries to be more fiscally responsible than they otherwise would be.


Having agreed-upon fiscal goals can justify and frame the choices that must be made and policymakers can decide how fiscal rules and targets can be used in relation to those fiscal decisions going forward. With that in mind, a fiscal target that establishes a common goal for policymakers to control the size of the federal debt relative to the economy, and well-designed fiscal rules that put the federal government on a path to achieve that target, could form part of a long-term plan to put the government on a sustainable fiscal path.







Key Considerations for the Design, Implementation, and Enforcement of Fiscal Rules and Targets in the United States

We identified seven key considerations to help Congress if it were to adopt new fiscal rules and targets. These seven key considerations are shown in table 6.

Following the table we discuss each key consideration, including illustrative examples from our case study countries—Australia, Germany, and the Netherlands. The experiences and lessons learned from other countries’ use of fiscal rules and targets can provide context for how fiscal rules and targets could be used in the United States (see appendix II for additional details on Australia’s, Germany’s, and the Netherlands’ fiscal rules and targets).

Table 6: Key Considerations for the Design, Implementation, and Enforcement of Fiscal Rules and Targets

Key consideration	Supporting explanation
Alignment with Fiscal Policy Goals and Objectives 	Setting clear goals and objectives can anchor a country’s fiscal policy. Fiscal rules and targets can help ensure that spending and revenue decisions align with agreed-upon goals and objectives.

Key consideration	Supporting explanation
<b>Design Tradeoffs and Features</b> 	<p>The weight given to tradeoffs among simplicity, flexibility, and enforceability depends on the goals a country is trying to achieve with a fiscal rule. In addition, there are tradeoffs between the types and combinations of rules, as well as the time frames over which the rules apply.</p>
<b>Legal Framework and Permanence</b> 	<p>The degree to which fiscal rules and targets are binding, such as being supported through a country's constitution or nonbinding political agreements, can impact their permanence, as well as the extent to which ongoing political commitment is needed to uphold them.</p>
<b>Integration with Budgetary Processes</b> 	<p>Integrating fiscal rules and targets into budget discussions can contribute to their ongoing use and provide for a built-in enforcement mechanism. The budget process can include reviews of fiscal rules and targets.</p>
<b>Flexibility to Address Emerging Issues</b> 	<p>Fiscal rules and targets with limited, well-defined exemptions, clear escape clauses for events such as national emergencies, and adjustments for the economic cycle can help a country address future crises.</p>
<b>Clear Roles for Supporting Institutions</b> 	<p>Institutions supporting fiscal rules and targets need clear roles and responsibilities for supporting their implementation and measuring their effectiveness. Independently analyzed data and assessments can help institutions monitor compliance with fiscal rules and targets.</p>
<b>Transparency and Communication</b> 	<p>Having clear, transparent fiscal rules and targets that a government communicates to the public and that the public understands can contribute to a culture of fiscal transparency and promote fiscal sustainability for the country.</p>

Source: GAO analysis of literature review and interviews. | GAO-20-561

## Alignment with Fiscal Policy Goals and Objectives

### Alignment with Fiscal Policy Goals and Objectives



Setting clear goals and objectives can anchor a country's fiscal policy. Fiscal rules and targets can help ensure that spending and revenue decisions align with agreed-upon goals and objectives.

Source: GAO analysis of literature review and interviews. | GAO-20-561

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Policymakers need to agree on the fiscal policy goals and objectives to frame their choices and to design fiscal rules and targets that align with them. The political will to work towards achieving agreed upon goals and objectives assists in preventing abandonment of the fiscal framework and use of fiscal rules and targets. The fiscal rules and targets, as well as the fiscal policy goals and objectives, should allow policymakers to make appropriate changes over time to meet the evolving fiscal needs of the country.<sup>25</sup>



Australia's Charter of Budget Honesty Act 1998 (Charter) establishes a broad fiscal policy objective to maintain the ongoing economic prosperity and welfare of the people of Australia and sets five fiscal management principles to help achieve this objective.<sup>26</sup> These principles include (1) managing financial risks prudently; (2) ensuring the fiscal policy achieves adequate national savings and moderates fluctuations in economic activity; (3) pursuing spending and tax policies consistent with a stable and predictable tax burden; (4) maintaining integrity of the tax system; and (5) ensuring policy decisions consider financial effects on future generations.<sup>27</sup> Each government considers these principles as it sets its fiscal strategy.

The Charter requires the government's fiscal strategy to, among other things, specify the government's long-term fiscal objectives—within which shorter-term fiscal policies are framed—for the budget year and the following 3 years. The strategy should also include key fiscal measures and targets to assess the government's progress towards its fiscal objectives and policies. The government can change its fiscal strategy at any point by releasing a new fiscal strategy.

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<sup>25</sup>Fiscal rules can also have implications for a country's monetary policy goals and objectives. However, issues related to monetary policy were outside the scope of our review.

<sup>26</sup>*Charter of Budget Honesty Act 1998*, sch. 1, pt. 3.

<sup>27</sup>"Financial risks" in Australia's Charter include risks such as those from excessive net debt, commercial risks from ownership of public trading enterprises and public financial enterprises, risks from erosion of the tax base, and risks from the management of assets and liabilities.

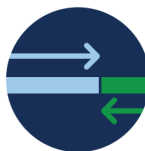


Source: GAO. | GAO-20-561

The Netherlands bases its fiscal targets on a coalition agreement, which is a set of political commitments developed and adopted by the political parties that form a governing coalition in the Dutch Parliament at the beginning of its 4-year term. The coalition agreement describes the coalition's policy goals and objectives for fiscal policy, education, and climate change, among other things. The coalition agreement also sets annual expenditure and revenue targets for the next 4 years that align with these policy goals and objectives.

## Design Tradeoffs and Features

### Design Tradeoffs and Features



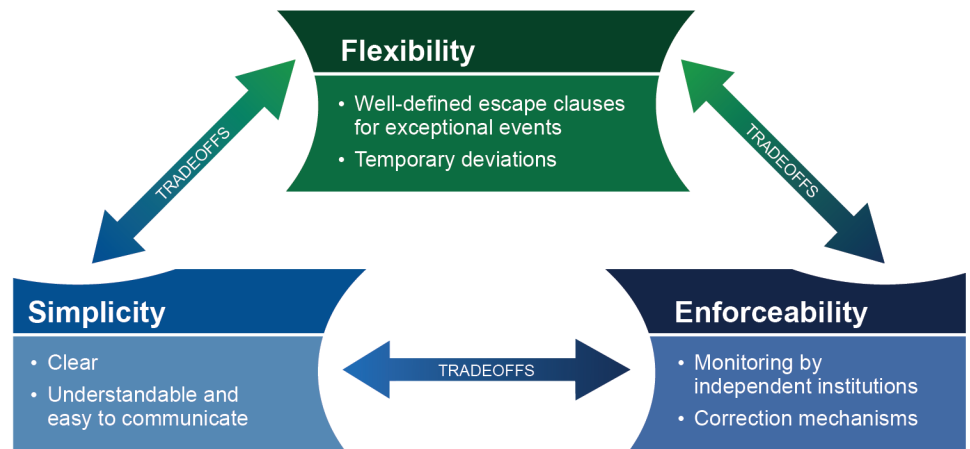
The weight given to tradeoffs among simplicity, flexibility, and enforceability depends on the goals a country is trying to achieve with a fiscal rule. There are also tradeoffs between the types and combinations of rules, and the time frames over which the rules apply.

Source: GAO analysis of literature review and interviews. | GAO-20-561

## Tradeoffs among Simplicity, Flexibility, and Enforceability

Fiscal rules can be designed in many different ways. Depending on the goals and objectives they aim to achieve, policymakers can consider the tradeoffs among simplicity, flexibility, and enforceability. Achieving fiscal rules that are simple, flexible, and enforceable is difficult. According to the IMF, prior to the global financial crisis of 2008-2009, countries that used fiscal rules expressed concerns about the rigidity of simple fiscal rules. These concerns resulted in countries adding exceptions and escape clauses to their rules. These changes made the rules more flexible and allowed countries to bypass the rules in times of emergency. Additionally, countries did not emphasize enforcement within the rules. Since the crisis, countries that use fiscal rules made reforms to make the rules more flexible and enforceable for policymakers to use in addressing long-term fiscal sustainability. However, according to the IMF, the rules became more complex. Tradeoffs among simplicity, flexibility, and enforceability are shown in figure 2.

**Figure 2: Balancing Tradeoffs among Simplicity, Flexibility, and Enforceability in Fiscal Rules and Targets**



Source: GAO analysis of International Monetary Fund information. | GAO-20-561



From 1969 to 2010, Germany used a “golden rule,” which was a budget balance rule applied during the budget planning process. Germany replaced the golden rule in 2011.<sup>28</sup> Under the golden rule, borrowing was only allowed to finance spending on investments. However, the rule’s exceptions created a wide scope for interpretation for the classification of certain expenditures as investment. Additionally, the golden rule included exceptions to limitations on borrowing during “disturbances to economic equilibrium,” and did not include explicit enforcement mechanisms. According to German government officials, this rule was challenging to implement and enforce given the investment exception. Reforms that resulted in Germany’s current rule have addressed some of the challenges of the golden rule because the current rule applies to the entire budget through the planning and execution process, while including limits on net borrowing.

### Tradeoffs between the Types of Fiscal Rules and Targets

Different types of fiscal rules and targets have benefits and drawbacks, including tradeoffs between simplicity, flexibility, enforceability, and other factors, as shown in table 7.

<sup>28</sup>Before the 2011 constitutional reform that amended article 115 of the Basic Law by replacing the “golden rule,” the rule limited public net borrowing to the amount of gross investment expenditures. The rule included exceptions and did not subject special funds to borrowing limits. Basic Law art.115 (2).

**Table 7: Benefits and Drawbacks of the Four Types of Fiscal Rules**

Type of rule	Benefits and drawbacks
Budget balance rule	<p>In their most basic form, rules targeting the overall budget balance are simple, but not flexible. Enforcing these rules can be complicated because the budget balance is influenced by economic conditions, which may not be within policymakers' control. Other types of budget balance rules can add flexibility, with implications for simplicity and enforceability. For example:</p> <ul style="list-style-type: none"> <li>• Golden rules are more flexible because they exempt investment spending. However, it can be difficult to precisely define investment spending, which lends additional complexity and makes the rule more difficult to enforce.</li> <li>• Cyclically-adjusted balance rules and structural balance rules both correct for the effects of economic fluctuations, which allows additional flexibility but makes the rules more complex and harder to enforce. However, because these rules correct for economic conditions, they target factors that are more directly within policymakers' control.</li> </ul>
Expenditure rule	<p>Expenditure rules are easy to communicate and monitor, which makes them generally simple to understand and easy to enforce. They can be designed to be flexible by exempting certain types of spending—such as investment or emergency spending—but exemptions make them more complex and can limit their effectiveness given that a portion of spending is not covered by the rule. Expenditure rules also target a part of the budget that is within policymakers' direct control. However, because fiscal sustainability is driven by both spending and revenue policies, it is important for fiscal rules to cover all spending as well as revenues.</p>
Revenue rule	<p>Revenue rules can be simple to understand and monitor. However, they may complicate other fiscal policy goals, such as stabilizing the economy. Revenue floors could lead to tax increases during economic downturns, while revenue ceilings could limit a government's ability to reduce debt during good economic times. In addition, because they do not constrain expenditures, revenue rules cannot ensure fiscal sustainability on their own.</p>
Debt rule	<p>Debt rules are simple because they provide policymakers with a goal that is linked directly to fiscal sustainability. However, they are difficult to enforce because the policymakers do not control the state of the economy, so the debt-to-GDP ratio is not directly within their control.</p>

Source: GAO analysis of International Monetary Fund reports and other literature. | GAO-20-561

Governments can use a combination of rules to help address the deficiencies of any one particular rule. According to the IMF, well-designed fiscal rule frameworks should include a debt target to set an anchor for fiscal policy, as well as a small number of operational rules (i.e., budget balance, expenditure, or revenue rules) that provide short-term guidance to policymakers. The debt anchor is used to set expectations about fiscal policy, while operational rules target factors that are within policymakers' control. When multiple rules are used, it is important to calibrate them so that they are consistent and so the operational rules guide fiscal policy towards the debt target over time.<sup>29</sup>

<sup>29</sup>IMF Fiscal Affairs Department, *How to Calibrate Fiscal Rules: A Primer* (Washington, D.C.: March 2018).



Source: GAO. | GAO-20-561

Germany's structural budget balance rule, which it calls the debt brake, includes an explicit set of requirements for the government to implement that are outlined in its constitution, the Basic Law. For example, the Basic Law specifies procedures for annual budgets, supplemental budgets, and a mechanism to keep track of excess spending and revenues during the budget year for unexpected emergencies and disasters.<sup>30</sup> The Basic Law outlines clear and explicit details of the debt brake, allowing the government, Parliament, and nongovernment think tanks to implement, assess, and enforce the government's compliance with the debt brake. The debt brake also includes some flexibility through escape clauses, as specified in the Basic Law, which allow for deviations from the debt brake in exceptional circumstances which are outside of the government's control, such as the country's response to COVID-19.<sup>31</sup>

Germany's federal budget balance rule, which it called the Black Zero, was an ongoing national political commitment to maintain no annual deficits.<sup>32</sup> According to German government officials, the Black Zero was simple to communicate and understand because it only included a goal for the government to maintain a balanced budget annually. However, the Black Zero was not flexible because the goal for achieving a balanced budget did not account for the impact of changing economic circumstances and was not responsive to cyclical conditions. According to German government officials and economic experts, the Black Zero was difficult to enforce because, given that it was only a political commitment, it did not have any specific enforcement requirements and was not binding for future governments.<sup>33</sup>

<sup>30</sup>Basic Law, arts. 110-112.

<sup>31</sup>The government is permitted to exceed Germany's constitutional borrowing limit in certain exceptional circumstances on the basis of a decision by the majority of the Bundestag's members. The German Bundestag approved its first supplementary budget for 2020 to counteract the effects of the COVID-19 pandemic on March 27, 2020. Among other things, the first supplementary budget authorized new borrowing by the Federal Ministry of Finance to cover the expenditures for COVID-19 response measures and lower-than-expected tax revenues. On July 2, 2020, a second supplementary budget was adopted to implement the economic stimulus and crisis management package previously adopted by the government.

<sup>32</sup>As a result of COVID-19's impact on Germany's federal budget, the Black Zero will no longer play a role in the foreseeable future, according to German government officials.

<sup>33</sup>According to German government officials, the Black Zero resulted from an effort to reduce, and not increase, public debt and bring the country's debt below 60 percent of GDP, as outlined by the Maastricht Treaty.



Source: GAO. | GAO-20-561

Australia's Charter outlines long-term, fiscal management principles, such as prudent debt management. Because the long-term principles of the Charter do not have specific numerical targets, it provides the government with flexibility to develop a fiscal strategy to meet its own fiscal policy goals and specific fiscal rules and targets within the strategy. Additionally, the Charter has been designed and implemented to provide the government with flexibilities that could be used to respond to unexpected circumstances, like natural disasters and economic downturns, through the government's ability to change its annual fiscal strategy statement.<sup>34</sup>

According to Australian government officials, the Charter does not have a formal enforcement mechanism, but rather relies on the government to comply with the objectives and targets within the fiscal strategy or explain why deviations were made. The government's performance towards its fiscal strategy is assessed through government reports provided to the public and Parliament.

## Time Frames for Applying Fiscal Rules and Targets

To coordinate decision-making across multiple time horizons, long-term fiscal goals can be combined with medium-term objectives (i.e., 3-5 years), and aligned with annual budgets to form a consistent strategy. Policymakers may wish to set long-term fiscal goals to address high levels of debt or serious fiscal imbalances that are not feasible to achieve within a few years. Since rules with long time horizons may create incentives to delay necessary changes in the short term, progress towards the long-term goals can be measured through medium-term objectives. In some cases, the duration of medium-term fiscal objectives corresponds with policymakers' terms of office, which can help align fiscal decisions with other policy priorities and avoid committing policymakers to decisions that were made by their predecessors.

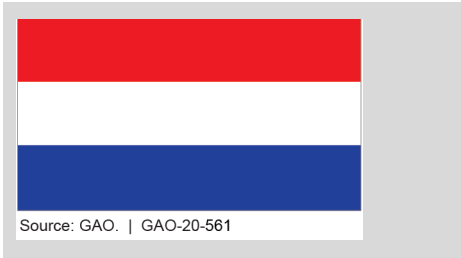
Another consideration in selecting the time horizon for a fiscal rule is the corresponding time horizon associated with certain significant policy decisions. Some policy decisions could have minimal fiscal impact in the short term but a much bigger impact in the longer term. For example, changes to national pension or social insurance programs might have their greatest fiscal impact a couple of decades into the future, so that the

<sup>34</sup>A new Australian government must publicly release its fiscal strategy on or before its first budget. The Charter includes contingencies that allow a new government's fiscal strategy to take effect when Parliament is not in session. The new fiscal strategy is to be considered when Parliament is back in session. *Charter of Budget Honesty Act 1998*, sch.1, pt. 4.



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impact of such policy decisions might not be captured by a fiscal rule with a shorter time horizon.



The Netherlands' fiscal targets are set for 4 years, corresponding with the government's term of office. It has separate expenditure and revenue targets, which are agreed to by the governing coalition in Parliament at the beginning of its term. The expenditure target is set for the entire government with different amounts provided to each ministry. It is set in real terms to account for changes in wages and prices. To allow for flexibility, excess spending in a given area is typically compensated for within the same ministry. If that is not possible, typically the Council of Ministers, which is comprised of the ministers from all the government ministries, will decide to make reductions in another ministry with Parliament's approval. Otherwise, Parliament may decide to deviate from the expenditure target.

The Netherlands' revenue targets are even more flexible than its expenditure targets because they consist of expected tax revenues. As a result, actual revenues may rise or fall depending on economic conditions. Because Parliament is free to make spending and revenue decisions that deviate from the coalition agreement, there is no formal enforcement. However, because the expenditure and revenue targets last only for the duration of the government's term to adhere to the rules policymakers only need to honor decisions that they have already made. In other words, they are not bound to decisions made by previous governments. According to Dutch government officials, policymakers generally have a strong desire to adhere to the rules they have made, and find a way to reach consensus when deviations are needed, as deviations without a consensus could lead to political instability within the multiparty governing coalition.

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## Legal Framework and Permanence

### Legal Framework and Permanence



The degree to which fiscal rules and targets are binding, such as being supported through a country's constitution or nonbinding political agreements, can impact their permanence, as well as the extent to which ongoing political commitment is needed to uphold them.

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Source: GAO analysis of literature review and interviews. | GAO-20-561

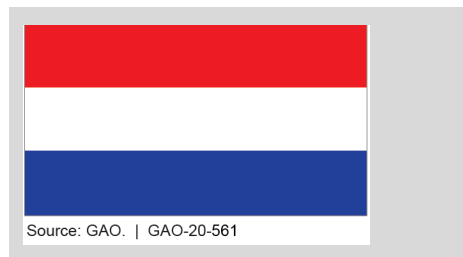
The degree to which a framework is binding impacts the degree to which changes to the framework can be made in the future. Rules embedded in stronger legal frameworks, like constitutional provisions, are more difficult to amend and are less likely to change as a result of a turnover in

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government. As a result, the policymakers abide by the constitutional provisions. In contrast, nonbinding frameworks, like coalition agreements, rely on ongoing commitment but can be changed easily. Regardless of the legal framework of the rule, when an ongoing commitment to the rule exists, policymakers may have less incentive to circumvent the rules or to pass laws that weaken them.



Germany's debt brake is outlined in the Basic Law. Since the debt brake is a constitutionally binding fiscal target, any amendments to its current form would require a two-thirds parliamentary supermajority vote. According to German government officials, the debt brake's status as a constitutional provision has a disciplinary effect on the government and Parliament because the Federal Constitutional Court has jurisdiction over potential cases involving, among other things, the violation of the debt brake.



In contrast, the Netherlands' national numerical expenditure and revenue rules are political commitments rather than formal laws or constitutional provisions.<sup>35</sup> Because the rules are political commitments, each new government sets new targets for expenditures and revenues for its 4-year term, and the government may choose to alter the rules to address national priorities, as needed.

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## Integration with Budgetary Processes

### Integration with Budgetary Processes



Integrating fiscal rules and targets into budget discussions can contribute to their ongoing use and provide for a built-in enforcement mechanism. The budget process can include reviews of fiscal rules and targets.

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Source: GAO analysis of literature review and interviews. | GAO-20-561

Fiscal rules can be most effective when they constrain the annual budget and the individual policy decisions that affect it by targeting factors that are within policymakers' direct control. As we have previously reported, enforcing a budgetary agreement that has already been made is more

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<sup>35</sup>The Netherlands' 2013 Sustainable Public Finances Act codified the principles of its fiscal policy, which had been in place since 1994, as well as its obligations under the EU fiscal rules. However, this law does not contain numerical fiscal rules. Sustainable Public Finances Act, 11 December 2013, Stb. 2013 (Neth.).

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successful than forcing an agreement where none exists.<sup>36</sup> As such, assessing fiscal rules and targets during the budget process can assist policymakers in determining if the fiscal rules and targets are achieving the goals and objectives to which policymakers have agreed. Continual discussions about fiscal rules and targets as part of the budget process can serve as a reminder to policymakers of their political commitments.



The objectives and targets set in the Australian government's fiscal strategy influence the framing of the annual budget and decision-making processes. However, Australian government officials stated that priorities will shift as the country addresses economic impacts in a given year, such as the 2019-2020 bushfires and the COVID-19 pandemic. The Charter requires the government to regularly report on its performance towards its fiscal strategy in various reports, including the budget, the mid-year economic report, and the fiscal outlook report.<sup>37</sup>

Similarly, whether compliance with fiscal rules can be measured in advance or after the fact has implications for policymakers. When rules are measured in advance (i.e., applied to budgets as they are enacted) they focus directly on the decisions made by policymakers at the time that they are made. However, when compliance with a fiscal rule is measured in advance, it relies on assumptions such as the rate of economic growth. Therefore, such measurement does not guarantee that actual budget outcomes at the end of the year will comply with the rules, and it may create incentives to rely on overly optimistic assumptions. Measuring rules after the fact, after the annual budget has been executed, provides more reliable information about whether the budget has complied with the rules, but does not provide timely input to policymakers during the budget process.

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<sup>36</sup>GAO, *Budget Process: Enforcing Fiscal Choices*, [GAO-11-626T](#) (Washington, D.C.: May 4, 2011).

<sup>37</sup>Australia's Mid-Year Economic and Fiscal Outlook report outlines the government's current fiscal position, including the economic outlook with budget estimates, current and projected debt statement, and budget forecasts and assumptions.



During the budget development process, according to German government officials, the government develops its draft budget in collaboration with the federal ministries and Parliament to ensure compliance with the debt brake. According to German government officials, the Ministry of Finance gives each ministry an expenditure ceiling during the budget process. Each ministry then uses a top-down budgeting process to identify its budget needs for the fiscal year. According to German government officials, the government and Parliament continue to adjust the draft overall budget and individual ministry expenditure amounts to ensure the final budget complies with the debt brake.

Additionally, in implementing the budget, the German government uses a separate budgetary account called a control account to track and monitor deviations from the debt brake. This helps the government address any issues that arise between the planned and actual budget.<sup>38</sup> For example, if actual net borrowing exceeds the upper limit for net borrowing at the end of the year, the difference is reflected in the control account. Conversely, if the net borrowing is smaller than planned, the excess amount is reflected in the control account.<sup>39</sup> Because the government must compensate for net borrowing beyond the upper limit in the control account during the next budgetary planning processes, this mechanism helps the government maintain compliance with its rule over time. The constitution outlines specific requirements, including limits to the amount of balances in the control account and the process the government should follow in reducing negative balances in the following fiscal year.

<sup>38</sup>The control account is a mechanism for the German government to safeguard the upper limit for annual structural deficits of 0.35 percent of GDP in the long run. Furthermore, it allows the tracking of deviations from permissible public finance targets, such as revenues and expenditures. Additionally, the control account does not include deviations from unanticipated economic changes that may affect the anticipated budget surplus or deficit. Act on the Implementation of Article 115 of the Basic Law, § 7, August 10, 2009, Federal Law Gazette I at 2702, 2704 [hereinafter Article 115 Act].

<sup>39</sup>During the 2011 to 2015 transition phase for the debt brake, the transfer of positive credits added to the control account were not allowed to create additional buffers for any net borrowing that began in 2016.

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## Flexibility to Address Emerging Issues

### Flexibility to Address Emerging Issues



Fiscal rules and targets with limited, well-defined exemptions, clear escape clauses for events such as national emergencies, and adjustments for the economic cycle can help a country address future crises.

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Source: GAO analysis of literature review and interviews. | GAO-20-561

Policymakers should consider how fiscal rules and targets can incorporate flexibility to support not only the fiscal policy goals and objectives of the government but also unforeseen circumstances. However, we have previously reported that exemptions to fiscal rules should be limited.<sup>40</sup> While the government needs flexibility to address unforeseen events, it is important to design fiscal rules that can be adhered to, absent a genuine crisis. When unpredictable events occur, such as COVID-19, escape clauses can allow policymakers to temporarily opt out of a fiscal rule to provide discretionary fiscal support without abandoning the rule entirely.

According to the IMF, escape clauses should only be used in a narrow and clearly-defined range of circumstances, and should have a specified path for returning to the rule after the event has passed.<sup>41</sup> In practice, however, it is challenging to define these characteristics with sufficient clarity because it is difficult to predict every possible scenario, and defining escape clauses in a way that accounts for a wide range of possible events creates a risk that they could be used to circumvent the rule.



Source: GAO. | GAO-20-561

Germany's debt brake includes escape clauses for natural disasters and extraordinary emergencies that are outside of the government's control and have a major impact on the government's fiscal position. In 2020, for the first time, the German government used the escape clause in response to the COVID-19 pandemic. Germany's escape clauses require a majority approval by Parliament. Additionally, Parliament requires the

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<sup>40</sup>[GAO-19-611T](#).

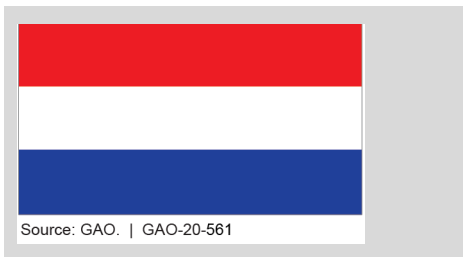
<sup>41</sup>Luc Eyraud, Xavier Debrun, Andrew Hodge, Victor Lledó, and Catherine Pattillo, *Second-Generation Fiscal Rules: Balancing Simplicity, Flexibility, and Enforceability*, Staff Discussion Notes No. 18/04 (International Monetary Fund, April 2018) and IMF, *Fiscal Rules—Anchoring Expectations for Sustainable Public Finances* (Dec.16, 2009).

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approval of a plan to reduce the gap between the additional spending and the debt limit in a reasonable time frame.<sup>42</sup>

The design of fiscal rules can accommodate fluctuations in the economic cycle and allow for a fiscal policy response that promotes economic stabilization. Fiscal policy can help stabilize the economy by increasing government spending and decreasing revenues during a recession, or spending less and increasing revenue during good economic times. To accommodate this approach, fiscal rules can be applied over the economic cycle instead of over individual years, or annual targets can be adjusted to account for economic conditions. Without these features, fiscal rules could lead to a fiscal policy that is not beneficial for the economy given the fluctuations in the economic cycle from year to year. For example, under an overall budget balance rule with no adjustments for the economic cycle, a recession could cause a decrease in revenues that would require a corresponding decrease in spending, which in turn would further depress economic activity.

One way that fiscal rules can support economic stabilization is by allowing automatic stabilizers to operate unhindered. Automatic stabilizers are intended to offset fluctuations in a nation's economic activity without direct intervention by policymakers. For example, when incomes are high, tax liabilities rise and eligibility for government benefits (such as unemployment insurance) falls, without changes in the tax code or other legislation. In contrast, when incomes fall, tax liabilities are lower and more people are eligible for government benefits.



The Netherlands' fiscal rules are designed to allow automatic stabilizers to operate during economic downturns. Expenditure and revenue ceilings for each budget year are kept separate. As a result, a decline in revenues in a given year does not lead to budget cuts or prevent an increase in spending during an economic downturn. Conversely, according to Dutch government officials, when revenues are higher than expected, the government generally pays down debt rather than increasing spending. Amid the COVID-19 pandemic, officials said the fiscal space that the Netherlands has created by reducing its debt in recent years is being used to support the economy.

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<sup>42</sup>Germany's Parliament adopted repayment plans for the two supplementary budgets for its COVID-19 response, which exceeded the debt rule of 0.35 percent of GDP, as of July 2020. The repayment plans stipulate that borrowing exceeding 0.35 percent of GDP will be repaid over 20 years in annual installments, beginning in 2023.

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## Clear Roles for Supporting Institutions

### Clear Roles for Supporting Institutions

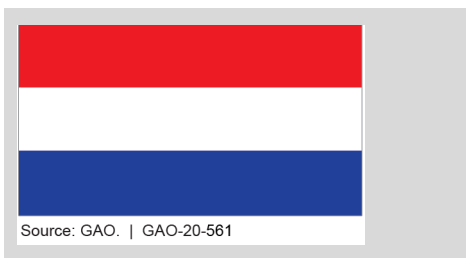


Institutions supporting fiscal rules and targets need clear roles and responsibilities for supporting their implementation and measuring their effectiveness. Independently analyzed data and assessments can help institutions monitor compliance with fiscal rules and targets.

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Source: GAO analysis of literature review and interviews. | GAO-20-561

Institutions supporting fiscal rules and targets provide policymakers and the public with information on the use of fiscal rules and targets. These institutions can include government agencies, independent fiscal councils, and nongovernmental organizations. These institutions can help measure fiscal rules before or after the budget is executed, which can provide data to determine the effectiveness of the rules. More specifically, independent fiscal councils can help monitor the implementation of the rules, provide objective assessments of economic forecasts and cyclical adjustments, and calculate appropriate adjustments to the rules, when needed. These institutions can work collaboratively or independently to process assessments of a government's performance and compliance with fiscal rules and targets, as well as a country's long-term fiscal goals.



The Netherlands' Bureau for Economic Policy Analysis is an independent government agency that produces economic and fiscal projections. The Dutch government uses these projections when budgeting. The Netherlands also has a second independent agency, the Council of State, which is an independent governmental advisory body to the government and Parliament and operates as an independent fiscal institution. It monitors the Netherlands' compliance with the EU and national fiscal rules using data produced by the Bureau for Economic Policy Analysis.

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## Transparency and Communication

### Transparency and Communication



Having clear, transparent fiscal rules and targets that a government communicates to the public and that the public understands can contribute to a culture of fiscal transparency and promote fiscal sustainability for the country.

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Source: GAO analysis of literature review and interviews. | GAO-20-561

Transparency and communication of fiscal rules and targets promote the public's engagement in fiscal discourse. Additionally, transparency and communication allow the public to hold the government accountable, for example through elections, to its agreed-upon fiscal goals and objectives.





Source: GAO. | GAO-20-561

Australia's Charter outlines requirements for the government to issue and publicly release several budget and outlook reports outlining its progress toward its fiscal strategy and overall fiscal objectives and targets for the budget year and the next 3 years. In addition, the government's intergenerational report, prepared every 5 years, assesses the long-term sustainability of the current government's policies over the next 40 years, including financial implications of changes to the country's demographics. According to Australian government officials, the public is aware of and relies on the information provided by the fiscal strategy and related reports to hold the government accountable to the plans it establishes through the Parliamentary process.



Source: GAO. | GAO-20-561

The Netherlands holds two major annual events that provide transparency over the government's budget. On Budget Day (also known as Princes' Day) each September, the King delivers his annual Speech from the Throne, after which the Minister of Finance presents the government's budget to Parliament. The budget is also made available to the public at this time. On Accountability Day each May, the Minister of Finance presents the government's annual financial report to Parliament. The Netherlands Court of Audit, as the country's independent supreme audit institution, also presents its audit of the annual financial report on that day. According to Dutch government officials, Budget Day and Accountability Day receive significant attention from the media and the public.

## Conclusions

The U.S. federal government continues to be on an unsustainable fiscal path. GAO, the Congressional Budget Office, and others have reported on the United States' growing debt and deficit, both of which continue to be affected by the fiscal and economic impacts of COVID-19. While fiscal policy is an important tool to support the economy during this crisis, once the economy recovers from the pandemic, fiscal rules and targets can be a part of a long-term plan to help move the federal government towards fiscal sustainability. The IMF and OECD have reported on the effectiveness of fiscal rules and targets in aligning decisions about spending, revenue, and debt, even as they provide the room for governments to address economic shocks.

In developing any new fiscal rules and targets, policymakers will face a number of tradeoffs that can affect how the rules and targets should be designed, implemented, and enforced. The key considerations discussed in this report can help policymakers navigate these tradeoffs as they work to develop appropriate fiscal rules and targets as part of a long-term plan to address the government's fiscal outlook and promote fiscal



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sustainability. No process can force choices that policymakers are unwilling to make. However, agreement on a fiscal goal can assist in framing the difficult choices that must then be made in designing the mix of fiscal rules and targets adopted.

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## Matter for Congressional Consideration

Congress should consider establishing a long-term fiscal plan that includes fiscal rules and targets, such as a debt-to-GDP target. In doing so, Congress should weigh the key considerations discussed in this report to help ensure proper design, implementation, and enforcement of those rules and targets. (Matter for Consideration 1)

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## Agency Comments, Third-Party Views, and Our Evaluation

We provided a draft of this report to the Secretary of the Treasury and the Director of the Office of Management and Budget (OMB) for review and comment. We received technical comments from the Department of the Treasury (Treasury), as well as comments from IMF and World Bank provided through Treasury, which we incorporated as appropriate. OMB had no comment.

We also provided excerpts of the draft report to OECD; EU institutions; and cognizant ministries and offices of the Australian, German, and Dutch national governments. These entities provided technical comments, which we incorporated as appropriate.

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We are sending copies of this report to the Secretary of the Treasury; the Director of OMB; cognizant IMF, OECD, and World Bank officials; EU institutions; and representatives of the Australian, German, and Dutch national governments, as well as interested congressional committees and other interested parties. This report will be available at no charge on our website at <https://www.gao.gov>.

If you or your staff has any questions about this report, please contact Jeff Arkin at 202-512-6806 or [arkinj@gao.gov](mailto:arkinj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on

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the last page of our report. Key contributors to this report are listed in appendix III.

A handwritten signature in black ink, appearing to read "Jeff Arkin". The signature is fluid and cursive, with the first name "Jeff" being more prominent than the last name "Arkin".

Jeff Arkin  
Acting Director  
Strategic Issues

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# Appendix I: Objectives, Scope, and Methodology

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Our objectives were to (1) assess the extent to which the federal government has taken action to contribute to long-term fiscal sustainability through fiscal rules and targets, and (2) identify key considerations for designing, implementing, and enforcing fiscal rules and targets in the United States.

To address our first objective, we analyzed the federal government's fiscal condition by reviewing Congressional Budget Office (CBO) reports and our prior work on the Nation's Fiscal Health.<sup>1</sup> We evaluated current and former federal fiscal rules and targets by reviewing relevant laws.<sup>2</sup> We interviewed CBO, Congressional Research Service, Office of Management and Budget (OMB), and Department of the Treasury officials with knowledge on federal budget and fiscal policy issues, as well as other countries' use of fiscal rules and targets.<sup>3</sup> We also interviewed knowledgeable officials from the International Monetary Fund (IMF), Organization for Economic Co-operation and Development (OECD), and World Bank. In addition, we interviewed experts on federal budgetary processes, fiscal policy, and fiscal rules and targets, including former CBO Directors, former congressional and OMB staff, academic researchers, and other experts from several policy research organizations that represented a wide range of political views. We selected these experts based on their published work on fiscal rules and targets or U.S. fiscal policy and recommendations from other experts.

We also conducted a literature review to assess how fiscal rules and targets can be used to control countries' deficits and debt. To conduct the literature review, we first identified relevant publications using a number of bibliographic databases, including EconLit, ProQuest, and Scopus. We searched for scholarly peer-reviewed articles, government reports, and publications from nongovernmental organizations (such as international

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<sup>1</sup>See GAO, *The Nation's Fiscal Health: Action Is Needed to Address the Federal Government's Fiscal Future*, [GAO-20-403SP](#) (Washington, D.C.: Mar. 12, 2020); *The Nation's Fiscal Health: Actions Needed to Achieve Long-Term Fiscal Sustainability*, [GAO-19-611T](#) (Washington, D.C.: June 26, 2019); and *The Nation's Fiscal Health: Action is Needed to Address the Federal Government's Fiscal Future*, [GAO-19-314SP](#) (Washington, D.C.: Apr. 10, 2019).

<sup>2</sup>Specifically, we analyzed: Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, 99 Stat. 1037 (1985), Budget Enforcement Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-1 (1990), Statutory Pay-As-You-Go Act of 2010, Pub. L. No. 111-139, 124 Stat. 8 (2010), and Budget Control Act of 2011, Pub. L. No. 112-25, 125 Stat. 240 (2011).

<sup>3</sup>OMB provided written information in lieu of an interview.

organizations) that were published between 2009 and 2019. We selected articles that focused on OECD-member countries' national fiscal rules or targets, the fiscal or economic effects of fiscal rules and targets, the costs and benefits of fiscal rules or targets, and similar themes. We conducted our search in May 2019 and subsequently added relevant articles identified during our background research. To systematically analyze these articles, one analyst reviewed each article to identify relevant themes. A second analyst reviewed each article to verify categorization decisions. We compared current and former federal fiscal rules and targets to information from our literature review, including IMF and OECD reports.

To address the second objective, we identified key considerations for designing, implementing, and enforcing fiscal rules and targets in the United States through our interviews with the federal agencies and experts listed above, as well as staff from the European Parliamentary Research Service, staff from the European Court of Auditors, and a member of the European Fiscal Board, and from information from the literature review described above.

We evaluated and synthesized the categorized information from the literature, as well as information from our interviews, to identify commonly-reported key considerations and supporting explanations for designing, implementing, and enforcing fiscal rules and targets. We shared a draft of the key considerations with the federal agencies and experts listed above to obtain their feedback before finalizing the list.

We conducted case studies of selected countries to identify illustrative examples of how other countries have successfully used fiscal rules and targets to help manage their long-term fiscal challenges. Specifically, we used illustrative examples from Australia, Germany, and the Netherlands to help explain the key considerations that we developed as part of this objective. We selected these three case studies based on the following criteria:

- membership in the OECD;
- collectively representing a variety of types of fiscal rules (budget balance, debt, revenue, and expenditure rules);
- collectively representing a variety of legal bases of fiscal rules (constitutional, statutory, and nonlegal bases such as political commitments);

- collectively representing a variety of institutions and enforcement mechanisms to support fiscal rules (formal enforcement procedures, an independent body that sets budget assumptions, an independent body that monitors implementation, and well-specified escape clauses);
- evidence of effectiveness of fiscal rules or targets, by selecting countries with debt-to-gross domestic product ratios below 75 percent, fiscal balances that have improved following the global financial crisis of 2008-2009, and for which experts or literature attributed good fiscal outcomes at least in part to fiscal rules and targets;
- length of use of fiscal rules (favoring countries with more long-standing rules, which allow more time to observe the effects of the rules);
- similarity to the United States (in terms of context for setting fiscal rules, political institutions, and economy); and
- impact of supranational fiscal rules, by selecting at least one country (Australia) not subject to supranational fiscal rules in contrast to other selected countries (Germany and the Netherlands) which are subject to the European Union's fiscal rules.

For the three selected countries, we reviewed reports and other documents on each country's design, implementation, and enforcement of its national fiscal rules from governments, policy research organizations, and other entities, as applicable. We collected and analyzed national debt data from the national governments. We interviewed national government officials and experts from policy research organizations and academia to obtain their views on the design, implementation, and enforcement of the fiscal rules in these three countries.

We conducted this performance audit from February 2019 to September 2020 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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# Appendix II: Fiscal Rules in Australia, Germany, and the Netherlands

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This appendix provides detailed information on the three case studies of other countries' fiscal rules and targets presented in this report: Australia, Germany, and the Netherlands. For each country, we present information on national fiscal rules and targets, how they are implemented, supporting institutions, and the country's fiscal outcomes.



Source: GAO. | GAO-20-561

## About the Fiscal Rules

The Charter of Budget Honesty Act 1998 (Charter) provides a broad fiscal policy framework and outlines principles for fiscal management for Australia's national government. The purpose of the Charter is to improve fiscal policy outcomes by requiring the national government to establish a fiscal strategy with supporting measures and targets that are to be based on the principles of sound fiscal management. In addition, it requires regular reporting on the government's fiscal outlook.

In summary, the five principles outlined in the Charter for sound fiscal management are to:

1. manage financial risks prudently according to economic circumstances, and maintain debt at prudent levels;
2. ensure that fiscal policy contributes to national savings and moderates cyclical fluctuations in economic activity;
3. pursue spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden;
4. maintain the integrity of the tax system; and
5. ensure that policy decisions consider their financial effects on future generations.

## Appendix II

# Australia Case Study Profile

## Implementation of Fiscal Rules

Australia's Charter requires the government to set and implement a fiscal strategy that includes objectives and priorities for fiscal policy. The government is able to revisit the strategy and make adjustments as needed. The current strategy is underpinned by a number of objectives and priorities for fiscal policy including:

- Maintaining the tax-to-gross domestic product (GDP) ratio at or below 23.9 percent of GDP.
- Building sustainable budget surpluses of at least 1 percent of GDP, as economic circumstances permit to build resilience and fiscal flexibility.
- Reducing government borrowing as a share of the economy over time, which links to improving net financial worth, reducing gross debt, and eliminating net debt.

The government's fiscal strategy guides its budget decisions, although it retains the capacity to respond to economic and other challenges, such as COVID-19, or implement new spending priorities during the year.

The Charter requires the government to report on its performance and to publicly release these reports. These reporting requirements are intended to promote transparency and accountability. Overall, the reports focus on the budget and economic outcomes measured against the targets and goals set in the fiscal strategy:

- **Fiscal Strategy.** Released by the new government, it establishes a framework for evaluating the government's progress towards fiscal policy goals.
- **Budget Economic and Fiscal Outlook report.** Released annually with each new budget, it provides information on the government's fiscal position for the budget year, the following 3 years, and the 10-year medium-term projections.
- **Mid-Year Economic and Fiscal Outlook report.** Released by the end of January or 6 months after each new budget, whichever is later, it provides a mid-year report on the government's progress against the fiscal strategy.
- **Final Budget Outcome report.** Released no later than 3 months after the end of each fiscal year, it reports on the final performance of the budget for the fiscal year.
- **Intergenerational report.** Released every 5 years, it assesses the long-term sustainability of current government policies over 40 years.

## Supporting Institutions

There are several supporting institutions that play a role in setting and implementing the government's fiscal strategy:

- **Australian National Audit Office.** As Australia's supreme audit institution, this office audits the Whole of Government Consolidated Financial Statements, which closely aligns with the final budget outcomes after the end of the fiscal year to ensure that they meet applicable requirements, including accounting standards.

- **Department of Treasury.** This department prepares the economic and fiscal projections and assumptions for the country, and fulfills the reporting requirements set forth by the Charter outlined above.
- **Department of Finance.** This department works with the Department of Treasury to provide current expenditure data for budget forecasting and projections. This budget information also helps the Department of Treasury fulfill the Charter's reporting requirements.
- **Parliamentary Budget Office.** This office is Australia's independent fiscal institution, aimed at enhancing Parliament's and the public's understanding of the budget and fiscal policy. It prepares policy costings and budget analysis for Parliament. Its self-initiated reports include medium-term fiscal projections that provide detailed information to the public on government performance based on the fiscal strategy and budget outcomes.

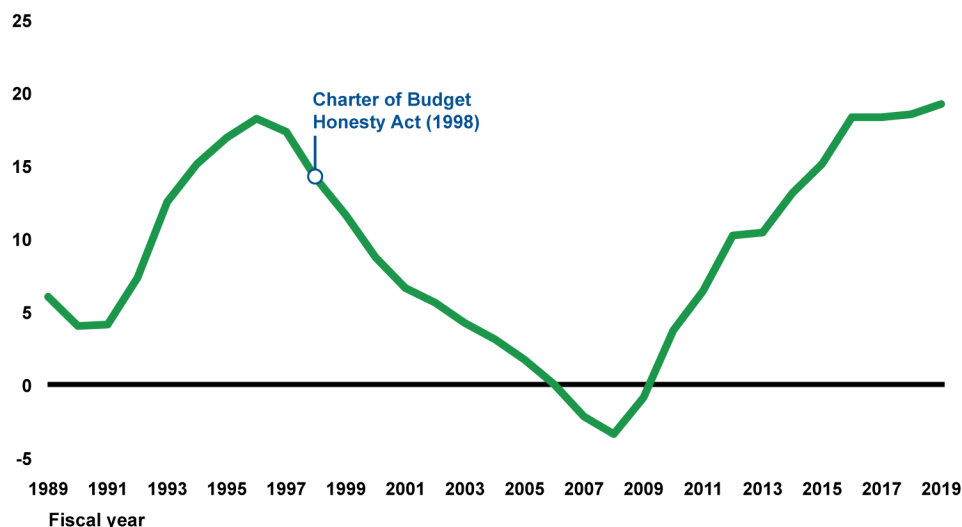
These institutions provide their data and reports to other government agencies and Parliament, and publish them on their public websites. While they are all involved with providing data and reports, none of the institutions have an enforcement role. Although the Charter did not provide for formal enforcement of the requirements, Australian government officials stated that continued political commitment to the Charter has entrenched its principles into national fiscal policy. In addition, the public relies on the information provided by the fiscal strategy and related reports to hold the government accountable to the plans it establishes, through the parliamentary process.

## Fiscal Outcomes

As shown in figure 3, Australia has seen a rise in debt around economic crises in the past, such as the global financial crisis of 2007-2009. With the government's 2019-2020 strategy focusing on spending constraints, Australian government officials stated that the federal government was on track to achieving surplus within the fiscal year, before the COVID-19 pandemic. Officials stated that the COVID-19 pandemic will have a significant impact on Australia's fiscal position.

**Figure 3: Australia's Debt-to-Gross Domestic Product Ratio, 1989-2019**

Net debt as a percentage of gross domestic product



Source: GAO analysis of Australia Treasury Department data and applicable law. | GAO-20-561

Note: Data represent general government net debt. Australia's fiscal year runs from July 1 through June 30. For the purposes of this figure, the later calendar year is referenced. For example, data for the fiscal year starting on July 1, 1988, and ending on June 30, 1989, is shown as 1989.



## Germany Case Study Profile



Source: GAO. | GAO-20-561

### About the Fiscal Rules

Articles 109 and 115 of the Constitution for the Federal Republic of Germany (Basic Law) outlines the fiscal goals and basic features of the federal financial management policy adopted by Germany's Parliament. In 2009, Germany amended article 115 of the Basic Law to include its current structural budget balance target—called the debt brake—and replace the “golden rule.”

The goals of the debt brake include safeguarding the sustainable development of public finances and promoting countercyclical fiscal policy in which deficits increase during an economic downturn and decrease (or achieve surplus) in good economic times. Starting in 2011, the debt brake requires a:

- structural budget balance target at the federal level, with net borrowing of no more than 0.35 percent of gross domestic product (GDP) from 2016 onwards; and
- budget balance at the state level, with no net borrowing, starting in 2020.

In addition to the debt brake, Germany's federal government reinforced an ongoing political commitment known as the Black Zero in 2018. The commitment included an agreement to maintain no annual budgetary deficits. As a result of COVID-19's impact on its federal budget, the Black Zero will no longer play a role in the foreseeable future, according to German government officials.

As a member of the European Union (EU), Germany is subject to the budget balance and debt rules of the Maastricht Treaty, the Stability and Growth Pact (SGP), and the Fiscal Compact.

### Implementation of Fiscal Rules

When executing the annual budget, the federal government uses a separate budgetary account—the control account—to track and monitor deviations from the debt brake. For example, if actual net borrowing exceeds the upper limit for net borrowing at the end of the year, the difference is reflected in the control account. The control account cannot exceed a negative balance threshold of 1.5 percent of GDP. Negative balances exceeding 1 percent of GDP reduce the borrowing authorization in the following year by the excess amount, but by no more than a maximum of 0.35 percent of GDP annually.

Exceptions to the debt brake can be made in extraordinary emergency situations and require a parliamentary majority for approval. For example, at the beginning of July 2020, Parliament approved new net borrowing to, among other things, finance the economic stimulus and crisis management package for Germany's COVID-19 response. Additionally, Parliament requires the approval of a plan to reduce the gap between the additional spending and the debt limit in a reasonable timeframe. According to German government officials, Parliament adopted a repayment plan over 20 years, beginning in 2023, for Germany's COVID-19 response.

The debt brake aligns with the fiscal rules and targets outlined by the Maastricht Treaty and the SGP. Under the Maastricht Treaty, Germany's overall deficit and debt are limited to 3 percent and 60 percent of GDP, respectively. Additionally, under the SGP, Germany has a medium-term objective of limiting its structural budget deficit of the general government to 0.5 percent of GDP. However, in March 2020 the EU declared an exception to these rules for all member states due to the economic downturn caused by COVID-19.

### Supporting Institutions

Germany has several supporting institutions that have a role in implementing, reviewing, and reporting on fiscal rules and targets:

- **German Supreme Audit Institution (Bundesrechnungshof).** This institution audits federal finances, including annual revenues, expenditures, and social security programs (i.e., health insurance, pensions, and unemployment). This institution also issues a financial audit of federal revenues, expenditures, and deficit to Parliament and the federal government. The report may include comments on individual cases of noncompliance with the fiscal rules by government departments.
- **Parliamentary Budget Committee (Bundestag).** This committee leads the deliberations on budgetary bills and amendments. The committee and its auditing subcommittee work closely with the Federal Court of Audit to oversee the execution of the budget and monitor the federal government's compliance with budget regulations, including the debt brake.
- **Federal Ministry of Economic Affairs and Energy.** This ministry produces economic forecasts and projections, including estimates of tax revenues, social security contributions, and expenditures, used

during the budget development process. These forecasts and projections determine where the economy is in the business cycle.

- **Federal Ministry of Finance.** This ministry prepares the draft budget for each fiscal year and ensures that it complies with the debt brake. The ministry also develops medium-term financial plans for a 4-year period. The ministry develops the German Stability Programme Report, an annual report to the EU with an update on Germany's medium-term fiscal plans over the next 4 years, and the Draft Budgetary Plan.
- **Stability Council (Stabilitätsrat).** Comprised of the Federal Ministers of Economic Affairs and Energy, Finance, and the Finance Ministers of Germany's 16 states, this council monitors federal and state budgets, focusing on compliance with EU-level fiscal rules and targets. Beginning in 2020, the Stability Council will monitor the national government's and the individual states' compliance with the debt brake for the previous, current, and following budget year.

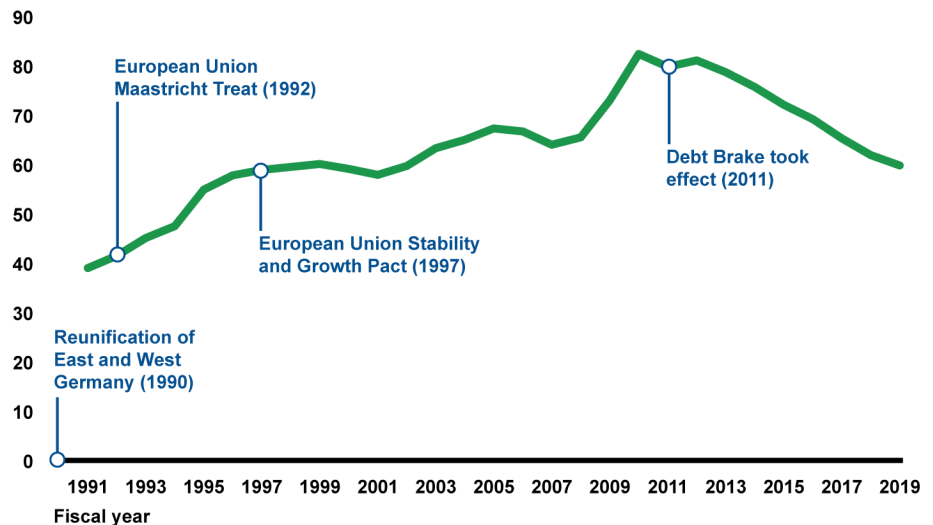
Data and reports on Germany's fiscal performance are publically available online to promote transparency and accountability. The data and reports issued by these institutions are provided to Parliament, independent research institutions, and other government ministries.

## Fiscal Outcomes

As shown in figure 4, Germany's debt rose after the reunification of East and West Germany in the early 1990s. Debt continued to rise during the global financial crisis of 2007-2009 and remained high during the European sovereign debt crisis of 2010-2012. According to German government officials, Germany's debt has declined since 2010. This may be due to a combination of instituting current fiscal reforms, such as the debt brake, and a strong economy. However, a significant increase in debt is expected by the end of 2020 due to COVID-19.

**Figure 4: Germany's Debt-to-Gross Domestic Product Ratio, 1991-2019**

General debt as a percentage of gross domestic product



Source: GAO analysis of information from the Deutsche Bundesbank and applicable law. | GAO-20-561

Note: Data on Germany's debt-to-GDP ratio begins following the reunification of East and West Germany in 1990. Data for 2018 and 2019 are estimated.

## Netherlands Case Study Profile



Source: GAO. | GAO-20-561

### About the Fiscal Rules

Since 1994 the Netherlands has had a “trend-based” fiscal policy that is designed to balance the budget over the economic cycle while allowing for fluctuations from year to year. The policy accomplishes this approach through separate rules for expenditures and revenues.

Expenditure ceilings (or targets) are set for three categories: central government, social security and labor programs (e.g., parental leave and unemployment benefits), and health care.

For revenues, the coalition agreement specifies changes to taxes at the beginning of each government’s term. From there, revenues act as an automatic stabilizer: actual amounts of revenues fluctuate over the economic cycle, increasing in good economic times and decreasing during economic downturns.

The expenditure and revenue sides of the budget are strictly separated. Revenue windfalls are not generally used to finance additional expenditures. Rather, they are used to reduce the deficit. This approach allows for a countercyclical fiscal policy in which deficits increase during an economic downturn and decrease (or achieve surplus) in good economic times.

As a member of the European Union (EU), the Netherlands is subject to the budget balance and debt rules of the Maastricht Treaty and the Stability and Growth Pact.

The Netherlands’ 2013 Sustainable Public Finances Act codified its trend-based fiscal policy and its obligations under the EU fiscal rules.

### Implementation of Fiscal Rules

Following general elections, multiple political parties will generally form a coalition to obtain a majority in the House of Representatives. The governing parties negotiate a coalition agreement, which describes policy priorities and their estimated fiscal effects for the government’s 4-year term. The coalition agreement also contains annual expenditure and revenue targets.

The Netherlands currently has expenditure and revenue targets for 2018 through 2021, based on the 2017 coalition agreement. For 2020, the expenditure ceilings are €144.3 billion for the central government, €85.6 billion for social security, and €77.6 billion for health care. Revenue targets are calculated based on the tax rates set by the coalition agreement and expressed in terms of changes compared to prior years: the coalition agreement called for policy changes projected to increase net revenue by €3.4 billion over the 4-year period.

The Netherlands’ fiscal rules allow for flexibility to respond to changes in the economic cycle, such as recessions. By separating expenditures from revenues, the rules are designed to allow automatic stabilizers to mitigate the effects of a recession. For example, increases in unemployment insurance and social assistance spending caused by economic conditions are not counted towards the expenditure ceilings. Excess spending that falls within the expenditure ceilings is generally compensated with spending reductions, usually from within the same ministry. In exceptional circumstances such as the COVID-19 pandemic, the governing coalition is free to make decisions that deviate from the original coalition agreement. For example, in response to COVID-19 the government announced a discretionary package of emergency measures, including wage support for businesses. According to Dutch government officials, the fiscal rules are not applied to coronavirus-related expenditures.

In addition, the Netherlands is bound by the Maastricht Treaty’s limits on its overall deficit and debt, which are 3 percent and 60 percent of gross domestic product (GDP), respectively. Under the Stability and Growth Pact, it also has a medium-term budgetary objective limiting its structural budget deficit to 0.5 percent of GDP. However, in March 2020 the EU declared an exception to these rules for all member states due to the economic downturn caused by COVID-19.

### Supporting Institutions

The Netherlands has several supporting institutions that have a role in implementing, reviewing, and reporting on fiscal rules and targets:

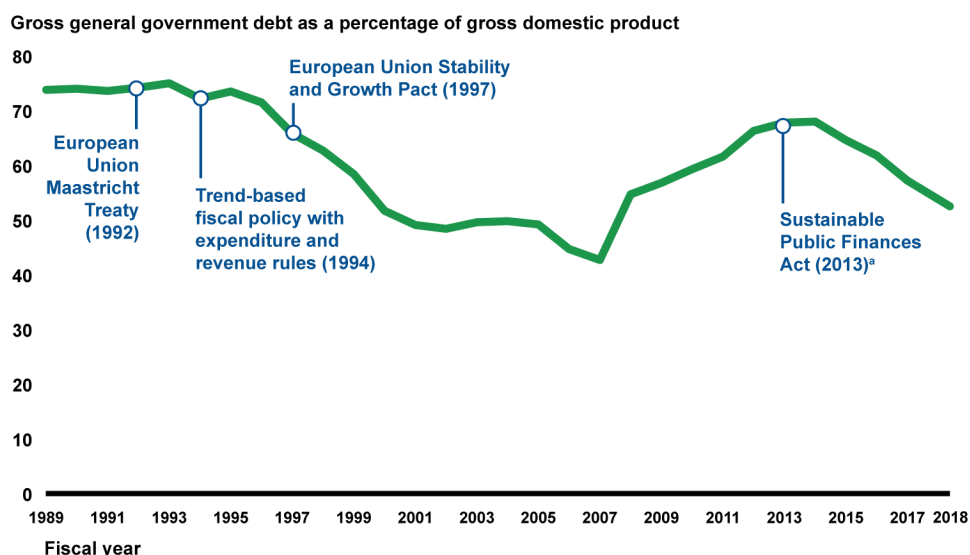
- Bureau for Economic Policy Analysis.** As the independent fiscal institution for the Dutch government, this bureau produces fiscal and economic forecasts that are used to set the Netherlands’ expenditure and revenue targets and to evaluate compliance with the Netherlands’ and EU fiscal rules. It produces several budget and economic forecasts, including a medium-term forecast at the beginning of the government’s term, short-term economic forecasts published four times per year, and long-term fiscal sustainability studies published every 4 or 5 years.

- **Council of State.** This independent governmental advisory body to the Ministries and Parliament is responsible for assessing the Netherlands' compliance with national and EU fiscal rules. Twice a year it publishes fiscal monitoring reports, which assess the Netherlands' compliance with EU and national fiscal rules.
- **Court of Audit.** As the Netherlands' independent supreme audit institution, the Court of Audit reviews the government's receipts and expenditures to ensure that they are consistent with applicable requirements.
- **Ministry of Finance.** This ministry coordinates the development of the Netherlands' annual budget. It is responsible for implementing the government's budget policy—including the fiscal rules—and keeping to the terms of the coalition agreement. It also develops the Netherlands' Stability Programme, an annual report to the EU that includes an assessment of the Netherlands' compliance with EU fiscal rules.
- **Study Group on Fiscal Space.** The government may convene this independent group in the year before a general election. It is comprised of high-ranking civil servants. It issues a report providing advice to the new government on fiscal policy, including fiscal rules and targets.

## Fiscal Outcomes

As shown in figure 5, the Netherlands has generally seen a decline in debt since the 1990s, coinciding with its adoption of national and EU fiscal rules. Debt increased during the global financial crisis of 2007-2009 and the European sovereign debt crisis of 2010-2012, but subsequently declined beginning in 2015. Officials said that fiscal rules helped improve the government's fiscal position in the wake of these events.

Figure 5: The Netherlands' Debt-to-Gross Domestic Product Ratio, 1989-2018



Source: GAO analysis of information from the Netherlands Bureau for Economic Policy Analysis and Ministry of Finance and applicable law. | GAO-20-561

Note: Data represent gross general government debt.

<sup>a</sup>According to Dutch government officials, the reduction in the debt-to-GDP ratio beginning in 2014 was caused by economic conditions. Although the Sustainable Public Finances Act was enacted in 2013, this law codified existing practices.

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Jeff Arkin, (202) 512-6806 or [arkinj@gao.gov](mailto:arkinj@gao.gov).

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## Staff Acknowledgments

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