ON THE RELATIONSHIP BETWEEN THE GOVERNMENT BALANCE AND THE CURRENT ACCOUNT: FISCAL CONSOLIDATION IN OPEN ECONOMIES

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Abstract

The relationship between fiscal policy and international trade, and their implications on economic growth, has not been widely discussed. The effects of fiscal policy on growth is a classical topic in economics, and we also can find research relating external openness and economic growth; but the extent to which fiscal policies could affect international trade policies, competitiveness and the trade balance is a question that has not yet been answered by the literature. The purpose of this paper is to study the relationship between the government balance and the current account in the scenario of a monetary union where fiscal consolidation is constrained by the fiscal discipline required by supranational agreements.


Keywords: Fiscal consolidation, fiscal rule, current account, monetary union.

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1. INTRODUCTION

The role of fiscal policy in influencing economic growth has been widely discussed by academicians and by policy-makers. The theoretical and empirical literature on fiscal policy and economic growth is rich and growing (see Díaz-Roldán and Martínez-López (2006), for a survey). In the short-run, changes in public deficit affect the aggregate demand; while in the medium and the long-run, the structure of taxation and public expenditure could affect, the incentives to save and invest, and the decisions on risk-taking activities. Moreover, in open economies fiscal policies also could influence decisions on exports and imports, and on foreign direct investment. Therefore, the channels of transmission of fiscal policies could affect competitiveness and, consequently, economic growth.

On the other hand, the relationship between openness and economic growth is a growing debated topic (see Krugman (1996), Frankel and Romer (1999) and Andersen and Babula (2008), among others). Not only economic openness will cause a country to be more vulnerable when facing external shocks, but also its inability to compete with other countries. In the spirit of Mundell (1961), the lack of flexibility of prices and wages will aggravate this problem.

In recent years following the financial and economic crisis, some debate on the role of economic policies has been opened. It is well known that the success of fiscal consolidation depends not only on the improvement of the primary fiscal balances, but also on the macroeconomic conditions such as the monetary policy regime and the exchange rate adjustment. However, the extent to which fiscal policies could affect international trade policies, competitiveness and the trade balance is a question that has not yet been answered by the literature.

Monacelli and Perotti (2008), study, both empirically and theoretically, the effects of a shock to government spending (on goods and services) on the terms of trade and the relative price of traded and non-traded goods. Using a structural VAR approach, they found that a rise in government spending generates an appreciation of the terms of trade and a fall in the price of goods relative to services (which is the empirical measure of the relative price of traded goods).

Nickel and Vansteenkiste (2008) analyze the empirical relationship between fiscal policy and the balance of payments. They estimate a dynamic panel threshold model for 22 industrialized countries and they found that in low and medium debt countries an increase in the fiscal deficit leads to a higher current account deficit (consumers react in a Keynesian manner). On the contrary, in high debt countries a rise in the fiscal deficit does not result in a rise in the current account deficit (consumers have become Ricardian). Therefore the main conclusion is that the relationship between fiscal deficit and current account deficit depends on the initial public debt level, because this variable affects private sector expectations.

Hussin et al. (2009) examine the impacts of trade openness and fiscal policy on economic growth in Malaysia using the autoregressive model consistent with the
endogenous growth theory. The results show that, overall, trade openness and fiscal policy have strong positive impacts on economic growth in Malaysia.

Barrios et al. (2010) estimate the determinants of successful fiscal consolidations and find that the repair of banking sector is a key condition, and that would be useful a proper coordination of national fiscal policies. They also stress that the initial public debt level plays a significant role to achieve a successful fiscal consolidation, but they do not explore the effects of fiscal adjustment on the external sector.

Riguzzi (2011), following a New Keynesian model, studies the extent to which the degree of openness influence the transmission mechanism of fiscal policy. He finds that openness to trade limits both the stimulating effect of government spending on output, and the contractive effect of higher taxes on output. Moreover, and in contradiction to the IS-LM Model, capital mobility and exchange rate flexibility do not limit fiscal effectiveness, but rather work as amplifiers of the effect of fiscal policy on output.

More recently, Karras (2012) tests the effectiveness of fiscal policy in open economies. Using annual data for 62 developed and developing economies, and for the years 1951 to 2007, finds that an increase in trade openness by 10% of GDP reduces the magnitude of the long-run fiscal multiplier by 5 or 6%. From another point of view, Camarero et al. (2012) explore the relationship between the current account and the net foreign assets using a multicointegration test, but they do not focus on the theoretical linkages behind.

As we can see, the public debt level seems to be determinant for the success of fiscal consolidation and its implications for external deficit. But the empirical results are inconclusive. In any case, none of the papers refereed study the relationship between government deficit and the current account deficit in the particular scenario of a monetary union, where fiscal consolidation is constrained by the fiscal discipline imposed by supranational agreements. We are also interested in analysing the relationship between fiscal policy and international trade, but our main contribution will be to explore such issue in the novel economic framework provided by a monetary union scenario, where we will consider the possibility of following an explicit fiscal rule to guarantee a medium-term budgetary position close to balance. To that aim, the purpose of this paper is to study the relationship between the government balance and the current account in the scenario of a monetary union.

The structure of the paper is as follows: in next section we will introduce the theoretical background of the empirical application, in section 3 we will perform and discuss some empirical results. Finally in section 4 a brief summary and some policy implications will be presented.
2. THE THEORETICAL BACKGROUND

In large economies, domestic economic policy decisions generate externalities on the outside world; and the greater is the degree of openness and economic integration, the greater are the effects of the interaction among the economies. The degree of openness can be measured by an increase of international trade in goods, services, and assets, because the prices of the items traded are affected, or even determined, by world markets.

The balance of payments of a country records all the economic transactions that have taken place during a given period between the country’s residents and the rest of the world. The official reserve settlements balance (i.e., the sum of the current and the capital account) of the balance of payments has a different meaning depending on the particular exchange rate regime. Under a fixed exchange rate regime, this balance can be used, though imperfectly, to measure the intervention in foreign exchange markets. In a managed floating system, in which the exchange rate is allowed to fluctuate but monetary authorities still intervene in foreign exchange markets in order to smooth out fluctuations in exchange rates, it is still an useful concept. Finally, under freely floating regime, when the monetary authorities let the exchange rate fluctuate, the calculation of the official reserve settlements balance loses interest.

Under a system of flexible exchange rates, there is no “balance of payments problem”. Exchange rate guarantees the disappearance of the balance of payments deficits or surpluses that would arise under a regime of fixed exchange rates. In the absence of government intervention, a purely monetary mechanism exists that can correct payments imbalances automatically, without requiring changes in output, prices or interest rates. In the absence of interventions in foreign exchange markets to fix exchange rates, the money supply is in principle under the control of the monetary authorities. This nominal monetary autonomy is obtained, however, at the cost of losing direct control over the exchange rates. On the contrary, the formulation of monetary rules for open economies should recognize that neither the price level nor the money supply may be controllable by domestic monetary authorities under a fixed exchange rate regime. In that way, a monetary rule defining a target rate of growth of Central Bank credit can be formulated not only for achieving the inflation targeting, but also with the purpose of keeping the external balance.

In last years, in the academic circles, establishing a monetary union has been suggested as an alternative to a system of fixed exchange rates (see Obstfeld and Rogoff (1995) and De Grauwe (2006), among others). In fact, from a macroeconomic point of view it is clear that a system of fixed exchange rates (and full capital mobility) implies that there is only one system-wide monetary policy. National currencies would become perfect substitutes through the irrevocable fixing of exchange rates if they became equally appropriate for the three classical functions of money, namely: unit of account, store of value and medium of exchange.

Our environment, the Economic and Monetary Union (EMU) started by 11 member countries of the European Union (EU) in January 1st 1999, is a good example
of that particular economic policy framework. A single monetary policy is the exclusive competence of an independent and supranational central bank, the European Central Bank (ECB), whilst other economic policies (budgetary and structural policies, as well as wage determination) generally remain the responsibility of the member states. The ECB formulates its policy in the light of developments in the euro area as a whole. Monetary policy is therefore well placed to respond, if necessary, to any symmetric shocks that might affect the currency area.

In this economic policy framework, the management of fiscal policy becomes an issue of special relevance. In line with the subsidiarity principle, national governments are in a position (subject to certain common rules) to deal with their respective economies, e.g., in the case of country-specific shocks. But, in contrast with the federal system of the United States of America (US), in the EU there is not a federal budget big enough to provide an insurance against shocks. Incorporating the insurance function to the EU budget would mean to reinforce fiscal competencies at the EU level, given that the size of its budget is still relatively small (Rubio-Guerrero and Ruiz-González, 2012). In fact, proposing structural reforms of the budget would require several institutional changes, such as reinforcing the role of the European Parliament, creating either a supranational authority on taxes or funds guaranteed by different budget rules, or establishing a joint decision mechanism for the coordination of fiscal policies.

In a monetary union, the degree and the mechanism for coordination of national economic policies differ according to how convincing the economic rationale for coordination is in the particular policy area. As mentioned before, a monetary union can be defined on the basis of achieving the inflation targeting, and also with the purpose of keeping external balance in the economy. On one hand, the large risk posed by fiscal imbalances to any monetary area stability justifies close rules-based coordination in budgetary policies. But, in the other hand, the fiscal discipline imposed by the monetary agreements could limit the scope of stabilization fiscal policies, and its implications on economic growth.

Summing up, in a monetary union, fiscal policy is the only demand policy aimed to achieve the stabilization goal; and, the monetary autonomy is obtained at the cost of losing direct control over the exchange rates. Therefore, member states of a monetary union would face special difficulties when dealing with external shocks. In the EMU, the fiscal policy is oriented to achieve output stabilization in the short-run, through the use of the public deficit and automatic insurance mechanisms. In the long-run the fiscal policy should guarantee the sustainability of public finances, and also it should contribute to economic growth through the structure of revenues and expenditures, and the public investment in physical and human capital (European Central Bank, 2004). However, as mentioned before, in the EMU the management of fiscal policy is constrained by the limits imposed to the deficit and the lack of a federal budget.
3. THE EMPIRICAL APPLICATION

As stated in the introduction, there is a debate about the utility and effectiveness of fiscal rules, and on their complementarities with discretionary fiscal policy measures and automatic stabilisers to deal with short-run fluctuations. Particularly, in EMU, the Maastricht Treaty stressed as basic that the Member States of EMU should avoid excessive deficits; and the reference values for deficit-to-GDP and debt-to-GDP ratios, have worked in practice as an explicit fiscal rule. But the success of any kind of fiscal rule remains an empirical question. Since the purpose of this paper is to study the relationship between the government balance and the current account in the scenario of a monetary union, we will use data of EU-27 countries (source Eurostat) from 1999 (the year in which the EMU started) to 2011.

Table 1 shows the government deficit (−)/surplus (+), the government debt, the current account (in percentage of GDP), and the GDP rate of growth (% change on previous year) for the EU-27, the Eurozone EU-17 and for Spain. In 1999 the government deficit and the government debt of EU-27 were −1.0 and 65.8 respectively; −1.3 and 71.6 for EU-17; while −1.4 and 62.4 for Spain. In 2011 the government deficit and the government debt of EU-27 are −4.4 and 82.5 respectively, −4.1 and 87.3; while −9.4 and 69.3 for Spain. After the economic crisis these figures are above the 3 and 60 limits required by the Maastricht Treaty. On the other hand, figures for current account and GDP growth were −0.1 and 3.0, for EU-27 respectively; −1.3 and 2.9 for EU-17; while −1.4 and 4.7 for Spain, in 1999, but in 2011 are −0.2 and 1.5, for EU-27 respectively; 0.1 and 1.4 for EU-17; while −3.5 and 0.4 for Spain. The economic crisis is not a good environment, and contributes to create difficulties when deciding how to finance the public deficit. In such a context, the scope of fiscal policies for stabilization purposes seems to be reduced in a monetary union. Moreover, the current account imbalances have amplified the effect of the actual economic and financial crisis in Europe and could difficult the recovery.

¿But to which extent fiscal consolidations have impact on competitiveness and it could limit the economic growth? In order to illustrate this question, we first will assume that both UE-27 and UE-17 countries could have made use of a fiscal rule to limit excessive deficits. ¿How would have changed the actual data on public deficit reported in Table 1? And the next question would be ¿What are the implications of using fiscal rules on current account and growth? To answer those questions, we will explore in a very simple way the relationships between fiscal discipline and the current account, and between fiscal discipline and the GDP growth.

In the first step we will calculate the value of public deficit given by fiscal rules\(^1\); and as second step, we will obtain the current account value resulting from the

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\(^1\) From a different point of view, Díaz-Roldán and Montero-Soler (2011) analyze the convenience of using fiscal rules for the New Member States (NMS) of the EMU. And they found that the success of fiscal policy decisions depend on the symmetric or asymmetric nature of the shocks to deal with.
use of fiscal rules. Finally we will estimate the effects of such kind of fiscal discipline on growth.

Table 1
Government deficit (-)/surplus (+), debt and current account (% of GDP)

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</table>

Source: Eurostat
- The government deficit (-)/surplus (-) is defined as the difference between the revenue and the expenditure of the general government sector.
- The debt corresponds to the consolidated general government gross debt at nominal value, outstanding at the end of the year.
- The current account registers the value of exports (credits) and imports (debts) of goods, services, income and current transfers.

3.1 Fiscal discipline and fiscal rules

In our first step, following Ballabriga and Martínez-Mongay (2003), we will consider a fiscal rule which relates an explicit public deficit target (in terms of the GDP), \( g^o \), with public debt deviations (in terms of the GDP) respect to its optimal level \((d_i - d^o)\), and the output level \( y \):

\[
g^o_i = - \left[ \delta(d_{i-1} - d^o) + \theta y \right] \quad i = 1, 2 \tag{1}
\]

The public deficit adjusts according to the following path, where \( 0 \leq \rho \leq 1 \):

\[
g_i = (1 - \rho)g^o_i + \rho g_{i-1} \tag{2}
\]

From equations (1) and (2), we obtain the fiscal rule:

\[
g_i = -(1 - \rho)\delta(d_{i-1} - d^o) + \rho g_{i-1} - (1 - \rho)\theta y \tag{3}
\]

Notice that if \((d_{i-1} - d^o) > 0\), then the country has a relatively high level of debt. And the opposite holds for \((d_{i-1} - d^o) < 0\).
We would like testing whether the public deficit would have been different if the EU-27 and the EU-17 countries would have followed a fiscal rule. And since we are also interested in exploring the implications of fiscal consolidation both in foreign sector and growth, we will relate public deficit with the rate of growth, \( \hat{y} \), instead of the output level, \( y \). In that way, our fiscal rule will be:

\[
g_{i} = -(1 - \rho)\delta(d_{i-1} - d^{o}) + \rho g_{i-1} - (1 - \rho)\theta \hat{y}
\]

And, according to the rule given by equation (4), we will calculate the “theoretical” public deficit in the three following scenarios:

(i) The fiscal authorities give identical weights to debt deviations and to the output level, being \( \delta = \theta = 0.5 \). And the deficit adjust, also, in the same proportion, being \( (1 - \rho) = \rho = 0.5 \). This will be the “symmetric” scenario.

(ii) The fiscal authorities are particularly concerned by fiscal discipline and they are averse to debt deviations, so, \( \delta = 0.75 \) and \( \theta = 0.25 \); because public deficit was high in the past, so, \( (1 - \rho) = 0.25 \) and \( \rho = 0.75 \). We will call this the disciplined, conservative or “debt averse” scenario.

(iii) The fiscal authorities are particularly concerned about economic growth, so, \( \delta = 0.25 \) and \( \theta = 0.75 \); and about the deficit target, so, \( (1 - \rho) = 0.75 \) and \( \rho = 0.25 \). And this will be the “growth promoting” scenario.

As is well known, in EMU the Maastricht Treaty stressed as basic that the Member States of EMU should avoid excessive deficits, no more than 3 in percentage of the GDP, and the government debt should not exceed the 60 per cent of the GDP. Those reference values for deficit-to-GDP and debt-to-GDP ratios, have worked in practice as an explicit fiscal rule. According to those requirements, the fiscal rules for the cases detailed above will be:

(i) “Symmetric” scenario:
\[
g = -0.25 (d_{1} - 60) + 0.5 g_{1} - 0.25 \hat{y}
\]

(ii) “Debt averse” scenario:
\[
g = -0.1875 (d_{1} - 60) + 0.75 g_{1} - 0.0625 \hat{y}
\]

(iii) “Growth promoting” scenario:
\[
g = -0.1875 (d_{1} - 60) + 0.25 g_{1} - 0.5625 \hat{y}
\]

In Table 2, we show the actual value for the government deficit/surplus, taken from Table 1; and the computed values for the government deficit/surplus, given by the fiscal rules under the three scenarios proposed above.
Table 2: Public deficit (-)/surplus(+)

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**Notes:** The row DEF show the actual value of government deficit (-)/surplus (+) as percentage of GDP (see Table 1). The rows DEFs, DEFda and DEFgp, show the results given by the fiscal rule in the three proposed scenarios (i), (ii) and (iii) in section 3.1.

Using fiscal rules seem to reduce public deficit in most of the cases, or even turn the deficit into a surplus. This outcome is more significant for the Spanish case, as can be seen also in Graph 1.
Graph 1.A: EU-27 public deficit

Note: The values of DEF, DEFs, DEFda and DEFgp correspond to those of Table 2.

Graph 1.B: EU-17 public deficit

Note: The values of DEF, DEFs, DEFda and DEFgp correspond to those of Table 2.

Graph 1.C: Spain public deficit

Note: The values of DEF, DEFs, DEFda and DEFgp correspond to those of Table 2.
3.2 Fiscal rules and the current account

In a second step, since we are interested in studying the implications of fiscal consolidations on external deficit, we would like to know the path of current account under the three scenarios previously proposed. In the spirit of the fiscal rule, given by equation (4), we will assume that the current account path, $CC$, depends negatively on the public deficit, $g$, and the output rate of growth, $\dot{y}$, and positively on the past current account $CC_{-1}$.

Using data on Table 1, we have estimated the relationship assumed above, and the results are (estimations by OLS, t-ratios in parenthesis):

For EU-27: $CC = -0.05g - 0.16\dot{y} + 0.81CC_{-1}$, $R^2 = 0.68$ $DW = 2.25$

($-1.61$) ($-2.59$) ($3.07$)

For EU-17: $CC = -0.03g - 0.07\dot{y} + 0.30CC_{-1}$, $R^2 = 0.63$ $DW = 2.25$

($-1.45$) ($-1.90$) ($2.12$)

For Spain: $CC = -0.12g - 0.37\dot{y} + 0.92CC_{-1}$, $R^2 = 0.85$ $DW = 1.51$

($-1.33$) ($-2.49$) ($10.57$)

So, we would write the foreign sector rule as:

$$CC = -(\alpha g + \beta \dot{y}) + \gamma CC_{-1} \quad (5)$$

In Table 3, we show the actual value for the current account, taken from Table 1; and the computed values for the current account, given by the foreign sector rules under the three scenarios proposed in section 3.1, and the values estimated for EU-27, EU-17 and for Spain.

### Table 3: Current account deficit

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**Notes** The row CC show the actual value of current account as percentage of GDP (see Table 1). The rows CCs, CCda and CCgp, show the results given by the foreign sector rule in the three proposed scenarios (i), (ii) and (iii) in section 3.1.
Graph 2.A: EU-27 current account

Note: The values of CC, CCs, CCda and CCgp correspond to those of Table 3.

Graph 2.B: EU-17 current account

Note: The values of CC, CCs, CCda and CCgp correspond to those of Table 3.

Graph 2.C: Spain current account

Note: The values of CC, CCs, CCda and CCgp correspond to those of Table 3.
Contrary to the effects of fiscal rules on public deficit, the implications on current account imbalances are not so relevant. The only exception is year 2008 for the EU-27 and EU-17.

3.3 Effects on economic growth

Finally, we would like to check how affect the use of fiscal rules, and its implications on the current account, to the GDP growth. We assume that the relationship could be as follows:

\[ \hat{y} = a_0 + a_1g + a_2d + a_3CC \]  \hspace{1cm} (6)

Where \( \hat{y} \) is the rate of growth; and \( g, d \) and \( CC \), are the public deficit, the public debt and the current account as percentage of GDP respectively, like the data shown in the Table 1.

Using data on Table 1, we have estimated the relationship given by equation (6), according to the results showed in Tables 2 and 3 under the three scenarios described in section 3.1. In other words, we have computed the values of GDP growth under the “symmetric”, “debt averse” and “growth promoting” scenarios. And the relationships are as follows (estimations by OLS, t-ratios in parenthesis):

For EU-27:

\[ \hat{y}_s = 22.88 - 1.18g_s - 0.38d_s - 0.67CC_s, \quad R^2 = 0.95 \quad DW = 1.74 \]

\[ \hat{y}_da = 26.86 - 1.36g_{da} - 0.46d_{da} - 1.17CC_{da}, \quad R^2 = 0.84 \quad DW = 1.82 \]

\[ \hat{y}_gp = 13.63 - 1.06g_{gp} - 0.22d_{gp} - 0.29CC_{gp}, \quad R^2 = 0.98 \quad DW = 2.25 \]

For EU-17:

\[ \hat{y}_s = 12.45 + 0.06g_s - 0.15d_s - 1.71CC_s, \quad R^2 = 0.42 \quad DW = 2.40 \]

\[ \hat{y}_da = 10.06 + 0.19g_{da} - 0.11d_{da} - 1.54CC_{da}, \quad R^2 = 0.44 \quad DW = 2.30 \]

\[ \hat{y}_gp = 13.48 + 0.04g_{gp} - 0.16d_{gp} - 0.75CC_{gp}, \quad R^2 = 0.42 \quad DW = 2.40 \]

For Spain:

\[ \hat{y}_s = 29.30 - 1.19g_s - 0.50d_s + 0.07CC_s, \quad R^2 = 0.67 \quad DW = 1.96 \]

\[ \hat{y}_da = 14.86 + 0.25g_{da} - 0.15d_{da} + 0.84CC_{da}, \quad R^2 = 0.65 \quad DW = 1.78 \]

\[ \hat{y}_gp = 15.15 - 1.24g_{gp} - 0.27d_{gp} - 0.18CC_{gp}, \quad R^2 = 0.95 \quad DW = 1.69 \]

In Table 4, we show the results given by the above relationships from data on Tables 1, 2 and 3. According to those results, the use of fiscal rules would not translate
in clear effects on current account deficit (see Table 3 and Graphs 2), but would reduce economic growth. In general the use of fiscal rules seems to smooth GDP growth path; put differently, we could say that fiscal rules act as a stabilization mechanism. Particularly, for the Spanish economy, the use of a “debt aversion” rule seems to be the best option: in that case, deficit and current account would contribute positively to economic growth. But when looking at the data for EU-17, actual GDP growth for years 2010 and 2012 show positive figures (2 and 1.4, respectively); however, when using any fiscal rules figures turn to be negative.

### Table 4: GDP growth

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Notes: The row GDPgwt show the actual value of GDP rate of growth (% change on previous year, see Table 1). The rows GDPgwt-s, GDPgwt-da and GDPgwt-gp, show the results given by the estimations reported in Tables 4, 5 and 6.

In Graph 3 we have plotted the government debt (% of GDP) reported in Table 1, and figures of GDP growth reported in Table 4. As can be seen, when the debt is stable (or even decreasing, as in the case of Spain) the growth path is also stable, and there is no so much difference when using different fiscal rules. However, when debt increases the growth path declines and the use of fiscal rules becomes relevant (look at Tables 1 and 4). This result would be in line with the conclusions of Nickel and Vansteenkiste (2008), and Barrios et al. (2010), who addressed that that the relationship between fiscal deficit and current account deficit depends on the initial public debt level, and that public debt level proves to be determinant for the success of fiscal consolidation.
Graph 3.A: EU-27 debt and GDP growth

Graph 3.B: EU-17 debt and GDP growth

Graph 3.C: Spain debt and GDP growth
4. SUMMARY AND POLICY IMPLICATIONS

In this paper we have tried to analyse the relationship between fiscal policy and international trade, in the novel economic framework provided by a monetary union scenario, where we will consider the possibility of following an explicit fiscal rule to guarantee a medium-term budgetary position close to balance. To that aim, we have study, in a very simple way, the relationship between the government balance and the current account and their implications on economic growth, in the scenario of a monetary union where fiscal rules are allowed.

Using fiscal rules seem to reduce public deficit in most of the cases, or even turn the deficit into a surplus. This outcome is more significant for the Spanish case. On the contrary, the implications of fiscal rules on current account imbalances seem not to be so relevant. But when computing the effects on economic growth, in general, the use of fiscal rules seems to smooth GDP growth path; put differently, we could say that fiscal rules act as a stabilization mechanism. This result is close related to the public debt figures: when the debt is stable (or even decreasing) the growth path is also stable, and using fiscal rules is not particularly important. However, when debt increases the growth path declines and the use of fiscal rules becomes relevant.

Our analysis shows in a simple way, that a current account deficit, joint with a high public debt, seems to constraint the recovery of economic growth. This situation becomes even more important in a monetary union, where competitiveness adjustments cannot be achieved through devaluation. Therefore, adjustments could be more costly since they would require a cut in public expenditures, real wages and even leading to higher unemployment. In this context, the way of implementation and the scope of financial adjustments are quite relevant.

REFERENCES


