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Fiscal Guardrails against High Debt and Looming Spending Pressures

Prepared by Julien Acalin, Virginia Alonso, Clara Arroyo, Raphael Lam, Leonardo Martinez, Anh Dinh Minh Nguyen, Francisco Roch, Galen Sher, and Alexandra Solovyeva

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Authorized for distribution by Vitor Gaspar and Pierre-Olivier Gourinchas

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Abstract*: Many countries have adopted fiscal rules to foster fiscal discipline, but compliance has been mixed. Recent policy shifts and heightened policy uncertainty further intensify spending pressures and persistent debt challenges, underscoring the need for stronger fiscal guardrails. Results from a major update of IMF databases on fiscal rules and councils suggest that two-thirds of countries have revised their fiscal rules but deficits and debt continue to be well above countries' rule limits. Robust correction mechanisms, with predefined timelines and measures, could better guide the return to rule limits and reduce sovereign spreads. In addition, supportive fiscal institutions, such as independent fiscal councils, reinforce compliance. Finally, revisions to fiscal rules to meet spending pressures should be carefully designed to preserve their integrity and transparency.*

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Author's E-Mail Address:	JAcalin@imf.org; VAlonsoalbarran@imf.org; MArroyo@imf.org; WLam@imf.org; FRoch@imf.org; LMartinez4@imf.org; ANguyen3@imf.org; GSher@imf.org; ASolovyeva@imf.org.

[1] Preparation of this Staff Discussion Note was supervised by Era Dabla-Norris and Giovanni Dell'Ariccia, with guidance from Emine Boz and Davide Furceri. The team is led by W. Raphael Lam and Francisco Roch with members from Fiscal Affairs Department, Institute of Capacity Development, and Research Department. The authors thank Gita Gopinath, Vitor Gaspar, Pierre-Olivier Gourinchas, Cigdem Aslan, Carolina Renteria Rodriguez, and participants in the IMF Workshop on Fiscal Guardrails in Brussels in March 2025 and IMF Workshop on Fiscal Rules and Councils in Santiago in June 2025 for constructive feedback and suggestions. The authors also thank IMF staff from country teams who provided inputs to the 2024 update of IMF Fiscal Rules and Fiscal Councils databases.

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Executive Summary

Over the past two decades, fiscal policy played a central role in responding to global shocks but at the cost of higher public debt. Large-scale stimuli during the global financial crisis and the COVID-19 pandemic increased public debt-to-GDP ratios. More recently, the rise in real interest rates associated with the normalization of monetary policy has reversed a decade of favorable financing conditions. As a result, fiscal space has shrunk in many countries, and vulnerabilities to future shocks have grown.

Countries have adopted fiscal rules as guardrails to foster fiscal discipline, but compliance has been mixed. Fiscal rules are long-lasting numerical limits on key budget aggregates, which are designed to contain excessive spending and the rise in debt. Empirical evidence suggests that fiscal rules could foster budgetary discipline (Azzimonti, Battaglini, and Coate 2016), signal a government's commitment to sound fiscal management (Hatchondo and others 2022a, 2022b), mitigate procyclical spending (Reuter, Tkačevs, and Vilerts 2022; Eyraud, Gbohoui, and Medas 2023), and coalesce political debate (Cao, Dabla-Norris, and Di Gregorio 2024). On average, only about 60 percent of countries have complied with their rules. Even before the pandemic hit, noncompliance was already widespread, and the crisis widened deviations from fiscal rule limits significantly. These deviations often proved persistent, as many countries lack credible adjustment paths to return to rule limits. Hence, fiscal rules are often seen as lacking bites, particularly amid continued pressures to delay fiscal adjustment.

Looking ahead, pressures on public finances are set to intensify, underscoring the need to establish stronger fiscal guardrails, and to ensure compliance with them. Public debt remains elevated and is projected to rise further in many countries. Governments face mounting demands to scale up spending on defense, population aging, and sustainable development needs. Uncertainty surrounding fiscal policy has risen, and foreign aid to developing countries could decline given recent major shifts in trade policy and rising geoeconomic tensions. These further complicate the credibility and enforcement of fiscal rules. Against this backdrop, strengthening fiscal rule frameworks to rebuild buffers is more urgent than ever.

More than two-thirds of countries have revised their rules since the pandemic, but these revisions have often not translated into better compliance following the expiration of escape clauses. Many countries have struggled to unwind large deficits and high debt without robust corrective mechanisms to guide the return to fiscal rule limits. A key missing link is the lack of supportive fiscal institutions—such as independent oversight and unbiased macro-fiscal forecasts. This, in turn, has undermined credibility and made compliance with fiscal rules difficult.

Addressing gaps in fiscal rules and improving compliance requires a multi-pronged strategy. Drawing on the IMF's Fiscal Rules and Councils databases, this Staff Discussion Note explores policies to improve compliance with fiscal rules. It highlights three key elements for improving compliance with fiscal rules in the face of growing policy uncertainty:

- A **risk-based fiscal anchor**—tailored to a country's debt-carrying capacity—can help ensure that deficit or expenditure limits reflect underlying risks. This approach involves setting a quantified fiscal anchor that accounts for the risks a government faces and linking it to annual operational limits on expenditures or the budget balance. The goal is to gradually build fiscal buffers and avoid debt distress. To be effective, the fiscal anchor should be easy to communicate, aligned with institutional capacity, and complemented by a range of indicators to monitor debt risks. Countries facing high uncertainty on debt carrying capacity or undergoing debt restructuring may find it more practical to set expenditure or deficit ceilings to stabilize debt or to place debt firmly on a downward path rather than anchoring to a specific debt level.
- **Robust correction mechanisms** with predefined triggers, timelines, and policy responses to potential slippage can guide the return to rule limits and reduce sovereign spreads. Evidence shows that rules with strong correction mechanisms durably reduce spreads by 30−75 basis points.

- **Supportive fiscal institutional frameworks**—including realistic macro-fiscal forecasts, expenditure controls, strong links between fiscal rules and medium-term fiscal frameworks (MTFFs), and independent fiscal oversight—play an essential role in improving compliance and accountability. Stronger institutions and rules are associated with smaller fiscal surprises, lower sovereign spreads, and a more disciplined fiscal policy discourse.

Revisions to fiscal rules should be carefully designed when accommodating investment and other priority spending. Simulations suggest that a blanket exclusion of priority spending or prolonged delays in adjustment can erode the integrity of rules and jeopardize debt sustainability. As countries prioritize growth-enhancing spending and address spending efficiency gaps, revisions to fiscal rules should account for available fiscal space, risks surrounding the debt outlook, and the impact of spending. Low-debt countries could ease rules within debt-stabilizing limits to scale up investment. In countries with constrained fiscal space, additional spending should be matched with higher revenues or expenditure reprioritization, otherwise loosening fiscal rules would put debt sustainability at risk.

I. Introduction

In a world of growing debt and policy uncertainty, fiscal challenges have come to the forefront. Over the past two decades, large fiscal support has cushioned major global shocks, including the global financial crisis and the COVID-19 pandemic. This support has, however, contributed to high public debt levels worldwide, increasing vulnerabilities to future shocks and constraining fiscal space to address rising demand for quality public services.[1] These pressures come at a time when interest rates are expected to rise as monetary policy normalizes, which would raise debt service burden and pose headwinds for public finances. As fiscal challenges intensify, countries are reconsidering how fiscal rules—defined as long-lasting numerical constraints on fiscal balance or expenditures—can be designed or revised to mitigate sovereign debt risks and guide fiscal policy in a more constrained environment.

Fiscal rules, adopted in more than 120 economies, can serve as vital guardrails for public finances, helping to reduce deficit bias and sovereign risks by committing to responsible fiscal policies. Over the last decade, countries have improved their risk-based fiscal rules by incorporating greater flexibility, which proved effective during the pandemic. However, compliance with these fiscal rules has been uneven, with an average compliance rate of about 60 percent across countries. At the same time, oversight from fiscal councils—technical nonpartisan entities entrusted as a public finance watchdog—has become more common, although their mandates and impacts often remain limited.[2]

Several considerations warrant revisiting existing gaps in the design of fiscal rules and frameworks at this juncture. Previous IMF studies underscore the importance of a risk-based framework to establish a debt anchor and a corresponding fiscal path aimed at stabilizing or reducing debt while accounting for risks (Eyraud and others 2018; Arnold and others 2022; Caselli and others 2022, Fatas, Gootjes, and Mawejje 2025). However, new challenges have emerged. First, intensifying spending pressures complicate efforts to adhere to fiscal rules limits, including in low-income developing countries that face a potential decline in foreign aid. Second, despite recent revisions, fiscal rules often remain complex, have narrow coverage, and exclude certain government entities or expenditures. Many existing rules lack mechanisms to guide policy when noncompliance occurs. In some instances, fiscal rules fail to establish an appropriate anchor to build buffers and mitigate sovereign risks. While large economic costs of sovereign risk are noted in policy debates and academic papers (Bianchi, Ottonello, and Presno 2021; Arellano, Bai, and Bocola 2023), countries often lack a clear and consistent approach for reducing these risks. Finally, fiscal rules are often not supported by strong fiscal institutions and governance structures. Collectively, these limitations hinder governments' ability to commit to fiscal discipline and comply with established fiscal rules.

Against this background, this note takes a fresh look at the design of fiscal rules and addresses the following questions:

1. *How have fiscal rules changed after the pandemic? Do these changes address pre-existing and new challenges in terms of compliance and flexibility to address spending needs?*
2. *How can fiscal rules be better designed to improve compliance and reduce sovereign risks?*

[1] Fiscal space is a multidimensional concept, broadly reflecting the extent a government can raise spending or lower taxes without endangering market access and debt sustainability (IMF 2016).

[2] In this note, fiscal council is defined as a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government's fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives (IMF 2013).

3. *Should fiscal rules be revised in response to looming spending pressures? If so, how should they be revised?*

This note finds that many countries have revised their fiscal rules since the pandemic; however, these revisions have not sufficiently addressed the issues of weak compliance. It highlights significant updates to the IMF Fiscal Rules and Councils databases, offering fresh insights into recent revisions and ongoing challenges. The enhanced data sets, covering 122 economies and 54 fiscal councils, provide broader country coverage and more detailed information on rules compliance and oversight (Alonso and others, 2025a). Since the pandemic, two-thirds of countries with fiscal rules have modified their frameworks, with varying success in achieving fiscal objectives. Significant deviations from established rules coupled with inadequate supportive fiscal institutions—such as independent oversight and macro-fiscal assessment —raise concerns about credibility and compliance.

The note presents new findings on enhancing the design of fiscal rules, emphasizing the importance of establishing a prudent fiscal anchor and effective correction mechanisms to ensure compliance with rule limits. It provides insights into calibrating a country's sustainable debt limit, which is important for setting a prudent fiscal anchor. To evaluate the effectiveness of fiscal rules and fiscal councils, the note first analyzes the impact of a sound corrective mechanism on sovereign spreads. It then illustrates that stronger fiscal rules and well-functioning fiscal councils correlate with reduced fiscal projection bias and a less expansionary political rhetoric on fiscal policy. These novel results highlight that merely having fiscal rules and councils is insufficient for maintaining fiscal discipline; rather, it underscores the importance of well-designed rules and effective oversight to enhance fiscal responsibility.

Finally, this note presents a model-based framework to examine the impact of additional public investment on debt risks under various scenarios. Simulation results indicate that blanket exemptions for public investment or the prolonged use of escape clauses can compromise rule integrity and undermine debt sustainability. For low-debt countries, relaxing overly tight rules within debt-stabilizing limits can help facilitate financing for public investment. In contrast, high-debt countries with limited fiscal space must offset additional investment through higher revenues or spending cuts to keep debt under control. Well-calibrated rules, paired with strong investment management frameworks, can preserve credibility and foster compliance.

II. Recent Developments in Fiscal Rules Frameworks

The recent release of the IMF Fiscal Rules and Fiscal Council databases offers an updated overview of fiscal rule frameworks across countries.[3] The update includes several significant enhancements, such as broader country coverage, detailed information on compliance and escape clauses, and new data on fiscal council communications. This data set is the first comprehensive compilation to include many small developing states. It also documents revisions to fiscal rules since the pandemic, providing insights into future fiscal rules designs as over two-thirds of countries have made revisions and established new fiscal councils.

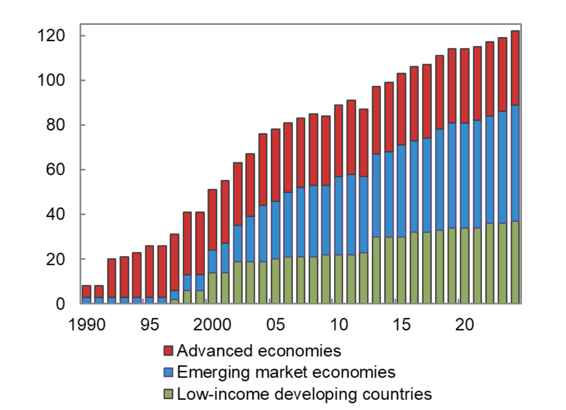
An increasing number of countries have adopted rules-based fiscal frameworks. As of the end of 2024, 122 economies have adopted numerical fiscal rules, representing a 6 percent increase since the

[3] Data are based on the 2025 update of the IMF Fiscal Rules at a Glance: 1985–2024 and Fiscal Council: 2024 Update databases, which updated the previous 2021 version. The updated fiscal rule database contains 123 economies (of which 1 country no longer adopt rules as of end 2024). The fiscal council database covers 54 fiscal councils operational as of the end of 2024 on a de jure basis. A numerical fiscal rule is a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates.

pandemic. This growth is largely driven by emerging market and developing economies (EMDEs) (Figure 1). Overall, more than two-thirds of countries have adopted multiple rules, typically combining a debt rule with annual budget limits on expenditure or budget balance. Many EMDEs have established fiscal rules to strengthen fiscal discipline or to avoid procyclical expenditures during significant fluctuations in commodities prices.

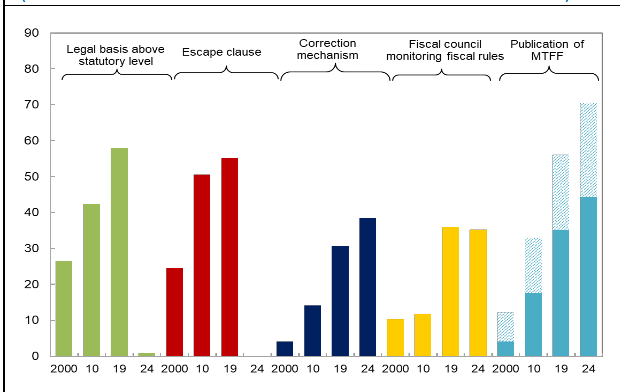
Although earlier fiscal rules were often too rigid, efforts to introduce greater flexibility have not translated into stronger compliance. Many countries have revised their fiscal frameworks to incorporate design features such as allowing automatic stabilizers to operate and embedding escape clauses for severe shocks (Figure 2). These changes aim to enhance the credibility of fiscal rules by allowing governments to accommodate adverse shocks without breaching their fiscal rule limits, addressing the reasons rigid rules were often disregarded. The increased flexibility in fiscal rules has proven effective during the pandemic, allowing governments to act swiftly to provide necessary support. However, despite this greater flexibility, compliance remains limited: fewer than two-thirds of countries adhere to their deficit rules on average (Figure 3), with lower share for emerging market and developing countries and debt rules. This finding suggests that flexibility in fiscal rules, while necessary, is insufficient on its own.

Figure 1. Fiscal Rules on the Rise: 1990–2024
(Number of countries with at least one fiscal rule)



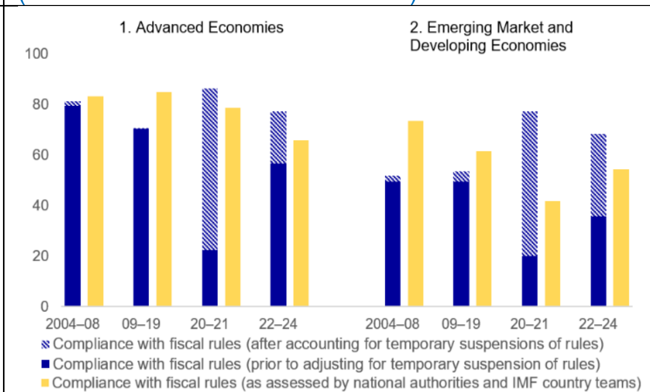
Sources: Alonso and others 2025a; IMF Fiscal Rules Database: 1985–2024.

Figure 2. Design Features of Fiscal Rules
(Share of countries with selected desirable features)



Sources: IMF Fiscal Rules Dataset: 1985–2024; and authors' compilations.
The solid blue bars under the publication of medium-term fiscal frameworks (MTFF) data column denote countries that publish MTFFs ahead of the budget cycles; shaded light blue bars denote countries that publish MTFFs but not ahead of budget cycles.

Figure 3. Compliance with Budget Balance Rules
(Percent of countries with fiscal rules)



Sources: Alonso and others 2025a; and IMF Fiscal Rules Database: 1985–2024.
Note: Solid blue bars denote compliance with rules under the measure of deviations of debt and deficits from fiscal rules limits, regardless of whether the rules are temporarily suspended or escape clauses are activated. Shaded blue bars denote an alternative measure in which cases of active escape clause or temporary suspension of fiscal rules are counted as compliant. Yellow bars denote the compliance rate as assessed. by the authorities or IMF individual country teams in the database. See Technical Annex 2 for details.

This note develops a "strength" index based on the attributes of fiscal rules to assess their effectiveness across countries and over time. Building on the measures developed in Davoodi and others 2022 and the European Commission's Fiscal Rule Index (2023), the index is constructed using four institutional criteria: (1) the statutory or legal basis of the fiscal rule, (2) the monitoring of fiscal rules,

(3) enforcement and correction mechanisms, and (4) flexibility and resilience to shocks (Technical Annex 2). Each indicator score is standardized between 0 and 1, with weights assigned on each rule.[4] The scores are summed up to create a single index, which serves as a proxy for the strength of fiscal rules. The estimated "strength" index shows a high correlation (with a correlation coefficient of 0.8) with the European Commission's index for EU countries.

Box 1. Assessing Compliance with Fiscal Rules

The task of assessing compliance with fiscal rules across countries presents both conceptual and practical challenges. First, significant heterogeneity exists in the design and coverage of fiscal rules: some exclude local governments, off-budget entities, or investment spending; this complicates cross-country comparisons. Second, compliance assessments must account for the activation of escape clauses or temporary suspensions, which were widely used during the pandemic. Third, many rules are forward-looking, meaning that current deficits or debt levels may exceed targets applicable only in the future, complicating the interpretation of deviations. Finally, compliance is not always solely about numerical adherence; it often involves meeting procedural requirements, such as presenting fiscal plans or adhering to adjustment paths within the rules-based framework.

To navigate these challenges, this Staff Discussion Note proposes a set of complementary indicators for assessing compliance with fiscal rules. The latest IMF Fiscal Rules Database includes direct assessments from national (or supranational) authorities and IMF country teams. In addition, this note introduces a simple metric based on observed deviations of fiscal outcomes from the relevant thresholds of fiscal rules, while accounting for instances where escape clauses are in effect or rules are suspended. Although not perfectly aligned with institutional assessments, these constructed indicators show a high degree of correlation with other studies (for example, Ardanaz, Ulloa-Suárez, and Valencia 2024; Larch, Malzubris, and Santacroce 2023) despite differences in methodology, definitions, and country coverage (Figure 3).

Persistent deviations from fiscal rule limits arise from several reasons: severe macro-fiscal shocks, limitations in the design of fiscal rules, and political economy constraints. Severe shocks—such as the global financial crisis and the COVID19 pandemic—can lead to sharp increases in deficits and debt due to falling revenues and emergency spending. However, even in the absence of crises, many countries exhibit chronic deviations, often without immediate market penalties. The extended period of low interest rates before the pandemic reduced market pressure on countries running high deficits, weakening incentives for compliance (Dovis and Kirpalani 2020). Second, many fiscal rules suffer from design limitations: some are overly complex—especially supranational frameworks (Blanchard, Leandro, and Zettelmeyer 2021)—or contain multiple, internally inconsistent targets (Davoodi and others 2022a). Limited independent oversight further reduces the enforceability of fiscal rules. Finally, compliance often falters due to the lack of political will. A persistent deficit bias, combined with the rising popularity of expansionary fiscal narratives across the political spectrum, has undermined commitment to fiscal rules (Cao, Dabla-Norris, and Di Gregorio 2024).

Although the overall strength of fiscal rules has improved, gaps in fiscal oversight and policy guidance regarding noncompliance remain. The strength of fiscal rules has improved across both advanced economies and EMDEs (Figure 4), reflecting more desirable design features, including escape clauses embedded in legislation. However, limited fiscal oversight persists, with less than half of countries having independent fiscal councils to monitor public finances by the end of 2024 (Figure 2). Moreover, majority of countries (with an even smaller share among EMDEs) do not have corrective mechanisms to manage noncompliance.

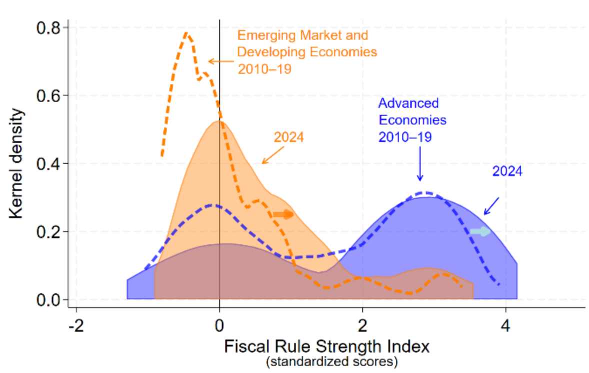
Countries also show limited accountability regarding escape clause provisions when suspending fiscal rules. Escape clauses provide flexibility to respond to severe shocks without undermining the edibility of fiscal rules. Although fiscal rules often prespecify the activation triggers for escape clauses, many do not specify the duration of these suspensions (Figure 5). This often results in extensions of 3 to

[4] The index does not capture all aspects of design and implementation, for example, whether the fiscal anchor is well calibrated.

4 years even after severe shocks have subsided. The lack of reporting on strategies to return to compliance adds uncertainty to fiscal policy, particularly in the aftermath of severe shocks.

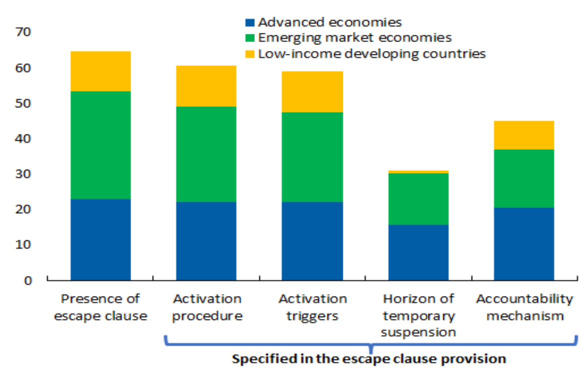
Fiscal deficits four years after the pandemic continue to exceed fiscal rule limits by a median of 2.0–2.5 percentage points of GDP for about 40 percent of advanced economies and 60 percent of EMDEs (Figure 6; Alonso and others, 2025b). In most countries, public debt has surpassed the ceilings in the debt rule by an average of 25 percentage points of GDP. Such large deviations from fiscal rule limits in many countries are driven by both severe shocks and limitations in the design of fiscal rules (Davoodi and others 2022a). During the severe shocks, the magnitudes and the share of countries that deviate from fiscal rule limits increased as expenditures or deficits tend to rise. But even in normal times, some countries have deficits and debt persistently exceeding their fiscal rule limits, partly because of multiple exclusions from the rules, limited fiscal oversight, or lack of fiscal adjustments to reduce debt and deficits. In recent years, fiscal adjustments have been limited, complicating the return to fiscal rule limits (Caselli and others 2022).

Figure 4. Fiscal Rules "Strength" Index
(Density based on the fiscal rule index with standardized scores)



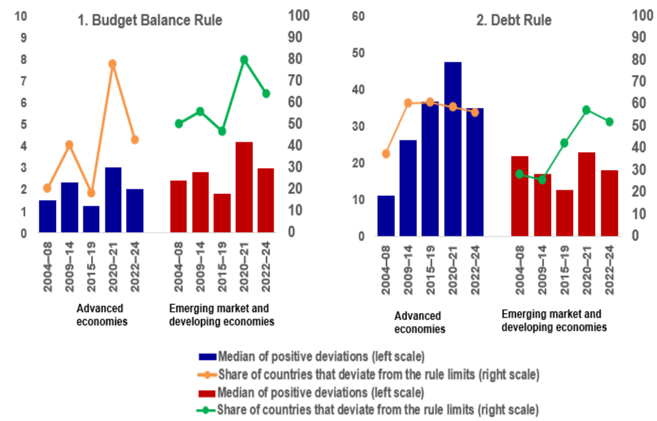
Sources: Alonso and others 2025a, forthcoming-b.
The strength index is based on four institutional criteria: (1) statutory or legal basis of the fiscal rule, (2) nature of the entity in charge of monitoring the fiscal rule implementation, (3) correction mechanism, and (4) resilience against shocks. The score is standardized by the unconditional mean and standard deviation. See Technical Annex 2.

Figure 5. Provision of Escape Clause in the Fiscal Rules Frameworks
(Share of countries with fiscal rules, percent)



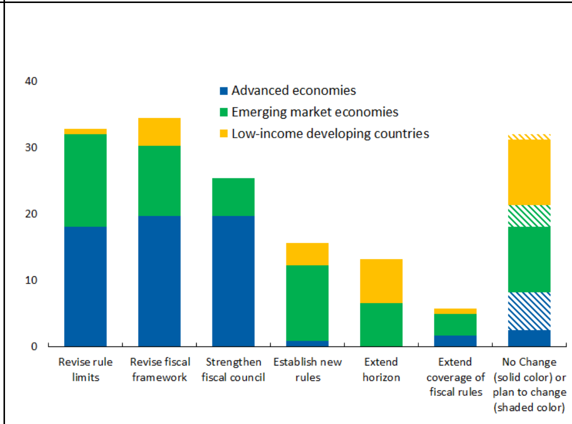
Sources: Alonso and others 2025a; and IMF Fiscal Rules Database: 1985–2024.

Figure 6. Deviations from Debt and Deficit Rule Limits
(Percent, left scale; percent of GDP, right scale)



Sources: Alonso and others 2025a, 2025b; and IMF Fiscal Rules Database: 1985–2024.

Figure 7. Recent Revisions of Fiscal Rules: 2020–24
(Number of countries with fiscal rules)



Sources: Alonso and others 2025a, forthcoming-b; and IMF Fiscal Rules Database: 1985–2024.

Governments have adopted various approaches to revise fiscal rule frameworks in an effort to improve compliance (Figure 7). Some countries have introduced new rules to complement existing fiscal rules to contain the debt buildup or demonstrate commitments. For example, Chile and Colombia have implemented a new debt rule, while the Dominican Republic has enacted its first fiscal responsibility law. Several countries have overhauled their fiscal frameworks; for example, the new EU fiscal rules allow for differentiated fiscal adjustments among member states based on their debt sustainability risks and reform efforts. A few countries have excluded entities or expenditure items from the rules (Armenia, Costa Rica). Others have extended the horizon to reach their fiscal anchors (countries in Eastern Caribbean Currency Union). A few countries have opted for greater flexibility by transitioning toward fiscal plans that emphasize multiyear commitments (India).

III. Designing Fiscal Rules to Improve Compliance and Mitigate Sovereign Risk

Policymakers face increasing challenges in aligning fiscal rules with the broader objectives of fiscal policy—namely, ensuring debt sustainability, stabilizing the economy amid cyclical shocks, and supporting long-term growth. While fiscal rules help anchor expectations and promote disciplined fiscal behavior, overly rigid rules can restrict a government's ability to respond to adverse shocks or limit essential public spending, ultimately undermining the very goals that fiscal rules are meant to support. The policy challenge lies in designing rules that strike a balance: preserving fiscal discipline to mitigate sovereign risks and ensure sustainability, while also maintaining sufficient buffers for stabilization and providing policy space for productive investment.

For fiscal rules to effectively achieve these objectives, they must be credible and complied with. Governments are more likely to adhere to rules when they include well-chosen fiscal anchors and attainable, yet sufficiently ambitious, fiscal paths. Enhancing compliance is not only critical to mitigate sovereign risk but also reinforces the stabilization role of fiscal policies by keeping borrowing cost in check and preserving policy space. Revisions to fiscal rules should focus on strengthening their design and implementation, which will, in turn, improve compliance. Several key areas warrant attention at this juncture, including (1) selecting a prudent fiscal anchor within a risk-based fiscal framework, (2) establishing a robust correction mechanism that specifies a fiscal adjustment path and guides the return to the fiscal anchor, and (3) strengthening fiscal institutions.

A. Selecting a Fiscal Anchor in a Risk-Based Fiscal Rule Framework

As debt and deficit levels exceed fiscal rule limits, policymakers face challenges in committing to an anchor that effectively guides policy in reducing debt vulnerabilities. This situation raises the question as to which indicators could serve as suitable anchors in fiscal rules (Blanchard, Leandro, and Zettelmeyer 2021; Arnold and others 2022).

The choice of fiscal anchor needs to be tailored to the specific circumstances of each country. While no single anchor is universally applicable, an effective fiscal anchor should be observable, easily communicated, and relate to debt sustainability risks. It should be calibrated to align with the operational fiscal rules regarding budget aggregates (such as a deficit or expenditure ceiling), and be commensurate with the country's institutional capacity. Each type of fiscal anchor has its merits and implementation challenges (Table 1).

Table 1. The Pros and Cons of Different Fiscal Anchors

Medium-term Fiscal Anchor	Pros	Cons
Debt-to-GDP ratio or net financial assets	· Easy to communicate · Relate directly to debt sustainability risks	· Maximum sustainable debt hard to pin down · Less practical for countries with very high debt
Budget balance	· Easy to communicate and under government direct control · Practical for countries with high debt	· Not directly linked to debt risk unless calibrated with debt sustainability analysis
Sovereign spreads	· Market-based indicators that allow to pin down debt capacity · Reflect expectations of policies and debt risk	· Not all countries have market access and liquid bond markets · Challenges in setting anchor due to large fluctuations
Interest expense	· Simple and reflect the ability to service debt	· Lagging indicator of sovereign risks
Other indicators (fiscal standards)	· Consider long-term sustainability ·Incorporate information on both the past and future debt obligations, GDP, and interest rates	· Complex and difficult to communicate ·Sensitive to macro-fiscal assumptions

Source: Authors' compilation.

- *Debt anchor*. Many countries adopt a debt anchor in their fiscal rules.[5] Debt-to-GDP ratios are observable, easy to communicate, and relate directly to debt sustainability risks. The debt anchor should have broad coverage for the general government (and in some cases, including government guaranteed debt for state-owned enterprises). However, countries with high debt that exceeds prudent levels often struggle to commit to a credible anchor (Arnold and others 2022). Furthermore, the sustainable debt limit varies over time and is sensitive to changes in interest rates and growth differentials (Mian, Straub, and Sufi 2021; Caselli and others 2022; Cao and others 2025). To address these concerns, some countries (Barbados, Ecuador) have established intermediate targets to guide debt reduction before returning to more prudent anchor level. Others aim to stabilize debt over the medium term or put it on a declining path without anchoring to a specific debt-to-GDP ratio (Australia, United Kingdom).
- *Budget balance*. This can serve as a medium-term fiscal anchor because it is observable, easy to communicate, and partially linked to debt sustainability risks, although it may contribute to procyclical spending. For countries with very high debt or EMDEs undergoing (or entering) debt restructuring,

[5] The debt anchor is often expressed as public debt-to-GDP ratio. Examples include the debt ceilings in Angola (60 percent of GDP), Chile (45 percent of GDP), Ecuador (long-term 40 percent after 2032 and intermediate targets), and West African Economic and Monetary Union (WAEMU) (70 percent of GDP).

anchoring prudent debt levels can be challenging. In such cases, a well-calibrated budget balance may help ensure that debt remains on a declining path. For example, Sri Lanka sets a primary expenditure ceiling in its Public Financial Management Act, while its MTFF establishes a primary balance level as the fiscal anchor, to restore debt sustainability. However, the budget balance may not fully account for risks arising from financial stress or unidentified debt which can affect debt dynamics and sovereign risks.

- *Net financial assets*. Some countries set the fiscal anchor as a floor on net financial assets (gross government debt net of liquid financial assets), particularly resource-rich countries with significant financial buffers (Eyraud, Gbohoui, and Medas 2023).[6] This approach, especially if accompanied by operational limits such as non-resource primary balance, accounts for precautionary buffers that protect budgets from large, persistent shocks in commodity prices while ensuring stable primary expenditures. However, whether countries should have a separate floor on assets and a ceiling on gross debt (dual anchors) is debatable. Dual anchors can be complex to implement and may lead to inefficient and suboptimal "borrow to save" arrangements. Instead of having dual anchors, countries could set a fiscal anchor on either gross debt or net financial assets, complemented by integrated asset-liability management to determine the right mix of debt and financial assets. At the same time, anchoring net worth (assets net of debt) is difficult to implement because asset values are subject to large variation.
- *Interest expense.* Some suggest that the fiscal anchor could focus on the debt servicing capacity by imposing a threshold on (net) interest expense as a share of government revenues or nominal GDP (Furman and Summers 2020). Interest expenses allow for the possibility that low interest rates enable higher debt limits. However, they are a lagging indicator reflecting past interest rates on existing debt and may not fully capture future risks (Comelli and others 2023).[7] In low-income developing countries (LIDCs), interest payment can be influenced by concessionary financing, which may not accurately reflect debt sustainability risks. Moreover, the potential for a sharp rise in interest expenses makes this anchor less practical as sizable fiscal adjustments would be required to reduce interest payments.
- *Sovereign spreads*. Given difficulties in determining a debt anchor, Hatchondo, Martinez and Roch (2022a, 2022b) argue that sovereign spreads could serve as a fiscal anchor, as they are a market-based indicator reflecting expectations of future policies and sovereign risks, which may prevent excessive borrowing. However, not all countries, especially EMDEs, have liquid sovereign bond markets that fully reflect market prices. Sovereign spreads are also less directly controlled by the government. Distortions in sovereign bond markets could also make the spreads less reflective of the underlying sovereign risks.

Fiscal anchors, such as fiscal standards, that allow for discretion (for example, Blanchard, Leandro, and Zettelmeyer, 2021) should be limited to countries with strong fiscal frameworks, implementation capacity, and institutions for fiscal oversight—conditions that are not easily met. For most EMDEs and some advanced economies, a prudent debt anchor alongside a consistent deficit or expenditure path may be

[6] When assessing debt sustainability, some argue that net worth in the entire public sector balance sheet is a better indicator than gross debt because government assets can generate returns or be sold to service debt (Chai, Harris, and Tieman 2024). Net worth is defined as net financial assets and nonfinancial assets generated from public investment and/or resources wealth underground. Setting net worth as fiscal anchor or for intergenerational objectives is difficult, owing to valuation and consolidation issues and the uncertainty regarding interest rates.

[7] Interest payments could be volatile even in advanced economies. For example, net interest payments in the United States were 2 percent of GDP on average before the pandemic and have increased to 3.6 percent of GDP in 2024.

practical for guiding fiscal policies. Other indicators—such as interest expense, sovereign spreads, or credit ratings—can be useful complements for monitoring debt sustainability risks.

A risk-based fiscal rule aims to establish a prudent fiscal anchor to build fiscal buffers against adverse shocks. This approach, elaborated in previous IMF studies (Caselli and others 2022), involves setting a quantified medium-term debt anchor that links to annual operational limits (expenditure or deficit ceilings) to gradually build fiscal buffers and avoid debt distress.[8] Countries will calibrate an expenditure or deficit ceiling such that debt will reach the anchor level with high likelihood over the medium term. As an illustration of a medium-term debt anchor, the risk-based approach would determine a safety margin (buffers) to ensure debt would not exceed certain threshold with a high probability, beyond which may lead to adverse outcomes such as higher spreads, ratings downgrade, debt distress, or increased scrutiny with supranational entity. But such a threshold is difficult to determine and thus is often set exogenously, while estimating the risk surrounding debt outlook is often based on regression relationships estimated based on historical shocks that may not account for future expectations (Eyraud and others 2018).

These limitations give rise to challenges because of large shifts in macro-fiscal conditions after the pandemic. Risks to the public finances also include macro-fiscal shocks on output, natural disasters, commodity price shocks, or unidentified debt from materialization of contingent liabilities and other fiscal risks, which tends to accumulate in booms but only gets recognized after severe shocks (IMF 2024; Comelli and others 2023; Horn and others 2024). Proper calibration of a fiscal anchor within this framework needs to account for risks, including fluctuations in sovereign spreads resulting from market discipline. The risk-based fiscal anchor should be reviewed periodically every four to five years to reflect changes in economic circumstances, such as growth prospects and long-term interest rates. Revisions should be carefully calibrated to avoid frequent changes that will undermine the credibility of fiscal rules.

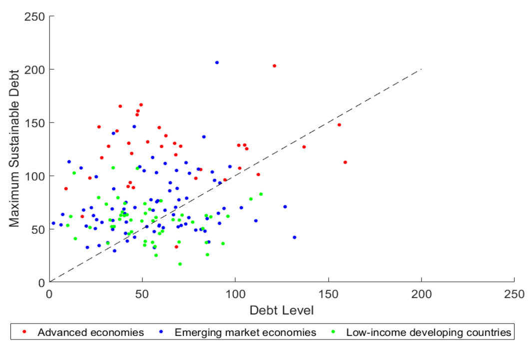
Recent analytical work illustrates how to calibrate a prudent medium-term debt anchor. First, it is essential to determine the maximum sustainable debt a country could afford (that is, the sustainable debt limit). Although there are challenges in determining what this limit might be in practice, current approach is to set an exogenous limit derived from cross-country analysis (Eyraud and others 2018) or estimate it based on maximum primary surplus that a country can achieve (Mian, Straub, and Sufi 2022). One illustrative approach described in Cao and others (forthcoming) provides further context and links key macro-fiscal parameters, such as potential growth, natural interest rates, and tax capacity, to ascertain how much debt a country can sustain without incurring sovereign distress. This analysis shows that debt limits vary significantly across countries and over time (Figure 8), suggesting that a fixed exogenous limit is not suitable for calibrating a debt anchor. This is relevant particularly in light of recent increases in global interest rates, which may reduce the demand for public debt (Brunnermeier, Merkel, and Sannikov 2022; Halac and Yared 2018) and potentially lower countries' sustainable debt limit. Additionally, the debt anchor will need to be set at a prudent level so that debt does not exceed the country's sustainable debt limit, taking into account associated risks.

The next step involves estimating risks to the debt outlook at the country level. Existing analytical frameworks, such as the IMF Sovereign Risk and Debt Sustainability Framework for market access countries or Low-Income Countries Debt Sustainability Framework, can be used to assess debt sustainability and associated risks. Another complementary option is to use the IMF Debt-at-Risk framework, which has an advantage of estimating the full distribution of debt outlook one to five years ahead, based on current and broader set of variables including sovereign spreads, political conditions,

[8] Expenditure rules are increasingly common, partly because they are easier to implement and contribute less to procyclical spending consistent with the medium-term fiscal anchor.

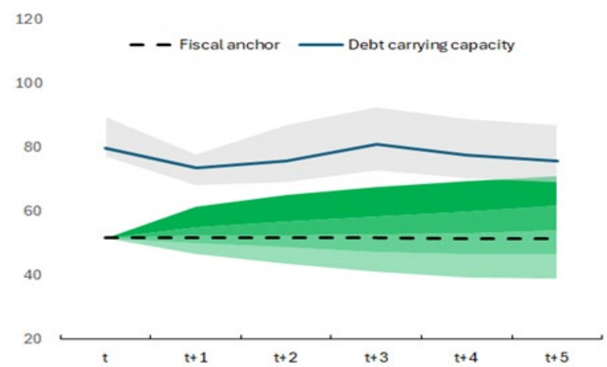
and other macro-fiscal variables (Furceri and others 2025). These two steps are interrelated, as the sustainable debt limit and debt risk are influenced by underlying macro-fiscal conditions. By combining these approaches, policymakers can better calibrate a prudent debt anchor that ensures debt remains sustainable and within the country's sustainable debt limit with a high degree of confidence (Figure 9).[9]

Figure 8. Current Debt Levels and Estimated Maximum Sustainable Debt Levels, 2024
(Percent of GDP)



Sources: Cao and others 2025; and IMF, World Economic Outlook database.
Note: AEs = advanced economies; EMs = emerging market economies; LIDCs = low-income developing countries.

Figure 9. Illustrative Risk-Based Fiscal Framework Accounting for Debt Risk and Sustainable Debt Limit
(Percent of GDP)



Sources: Cao and others 2025; and Furceri and others 2025.
The maximum sustainable debt is computed based on the debt capacity as in Cao and others (2025), which shows a tractable way to express the sustainable debt level as a function of interest rates, growth, risk premium, government spending, and tax capacity. The debt-at-risk framework refers to the 95th percentile of the debt distribution three years ahead, estimated based on a quantile panel regression (Furceri and others 2025). The fiscal anchor can be set such that the debt-at-risk would not exceed the maximum sustainable debt level with high confidence over the medium term.

B. Establishing a Corrective Mechanism

Corrective mechanisms are sometimes raised as an important design feature to establish a credible path for returning to fiscal rule limits. A corrective mechanism specifies the fiscal actions that governments would undertake when fiscal rules are not adhered to. This mechanism is activated when countries exit the escape clause or deviate from the rule limits due to noncompliance (Figure 10). Corrective actions can take different forms, including additional reporting and the formulation of adjustment plans that detail specific concrete revenue and expenditure measures.

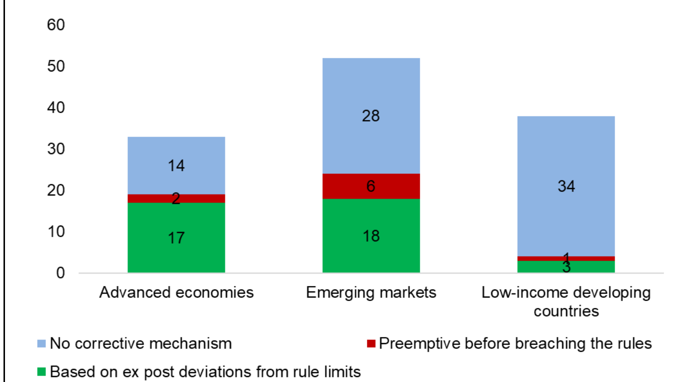
This note presents empirical findings on ways in which the adoption of fiscal rules with prespecified corrective mechanisms affects sovereign spreads for six countries (Technical Annex

[9] Hatchondo, Martinez, and Roch (2022a) show how to calibrate a prudent medium-term spread anchor.

1).[10] The analysis focuses on these countries because their fiscal rules incorporate mechanisms that trigger fiscal adjustment as the debt-to-GDP ratio surpasses pre-specified thresholds. Such mechanisms can help shape expectations regarding future budget balances and mitigate deficit bias. The empirical strategy employs the synthetic control approach in Abadie (2021) and Lang, Mihalyi, and Presbitero (2023), building upon a large literature on the determinants of sovereign spreads (Afonso and Guimarães 2015; Heinemann, Osterloh, and Kalb 2014; Iara and Wolff 2014).

Empirical results suggest that sovereign spreads are lower as a result. Specifically, sovereign spreads decreased in countries with fiscal rules that include mechanisms specifying thresholds and corrective measures, relative to the synthetic control group, shortly after these rules are approved. For instance, Figure 11 shows the decline for Cyprus and Poland. On average, sovereign spreads declined by about 10 percent (or on average 30 basis points) after six months and more than 25 percent (or on average 75 basis points) after one year compared to the control group (Figure 12). The compression of spreads effects is further confirmed using alternative empirical approaches (Technical Annex 1).

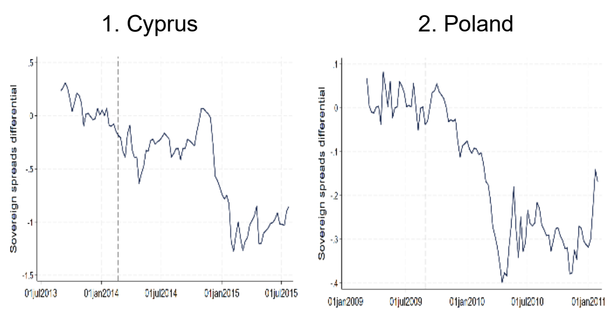
Figure 10. Correction Mechanisms in the Fiscal Rules Framework
(Number of countries)



Source: Alonso and others 2025a; and IMF Fiscal Rules Database: 1985–2024.

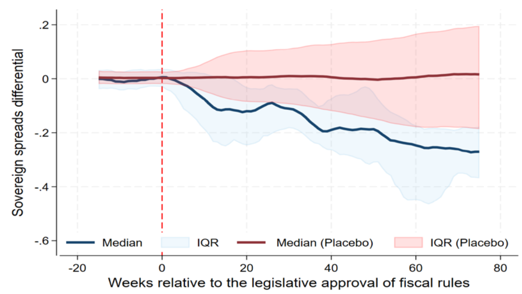
[10] The analysis covers six countries that adopt prespecified correction mechanism, namely Armenia, Costa Rica, Cyprus, Czech Republic, Poland, and Slovak Republic. Their correction mechanisms in fiscal rules share common features that specify a tightening of fiscal stance through concrete measures when debt exceeds prespecified thresholds.

Figure 11. Sovereign Spreads Differentials for Selected Countries with Prespecified Corrective Mechanism (Difference in spreads in logarithms)



Source: Acalin, Martinez, and Roch (2025).
Note: The panels show the country-specific log spread differences among the countries under study. The vertical axis shows the sovereign spreads differential.

Figure 12. Sovereign Spreads and Correction Mechanism
(Difference in spreads in logarithms)



Source: Acalin, Martinez, and Roch (2025).
Note: The figure shows the median and interquartile range of the log spread (12-week moving average) difference among countries with a robust correction mechanism (Armenia, Costa Rica, Cyprus, Czech Republic, Poland, and Slovak Republic) and their respective synthetic control group (blue), as well as the placebo effect using the same treatment dates for all countries in the donor pool and their respective synthetic control group (red).

The design of the corrective mechanisms should consider several key elements, including the trigger, timeframe, and procedures of the adjustment measures:

- *Trigger.* The corrective mechanism can be triggered ex post based on actual deviations when fiscal rules are breached or noncompliant. It may also have preemptive triggers that serve as early warnings before rule limits are breached. For example, the corrective mechanism under the European Fiscal Compact includes both preemptive and reactive triggers. Ecuador and Spain mandate corrective actions when fiscal outcomes are close to the fiscal rule limits. Some countries implement progressive triggers with corresponding tighter measures. For example, Czech Republic sets thresholds on the debt-to-GDP ratios, each involving larger fiscal adjustments if triggered.[11] Such mechanisms are supported by economic theory, which posits that the fiscal reaction function involves a stronger primary balance (less deficit) when debt and associated risks rise.[12] Having a limited number of "debt brake" thresholds can also reduce the complexity and curb incentives for circumvention.[13]
- *Timeframe of correction.* In the event of deviations, many fiscal rules require corrective actions to be implemented within one and a half or two years (Finland, Spain) after the breach, and sometimes

[11] Fiscal rules with a robust correction mechanism and stronger fiscal response resemble the Taylor rule in monetary policy. Leeper (2010) notes that there are important lessons from monetary policy for fiscal policies and managing fiscal risks.

[12] This suggests that fiscal policy is consistent with debt sustainability (Bohn 1998, 2008). Hatchondo, Martinez, and Roch (2023) show that for a government that can credibly commit to future borrowing plans, the optimal fiscal plan involves more ambitious fiscal adjustments when risk is heightened. Similarly, Sublet (2023) shows that the optimal fiscal rule entails a gradual schedule of tighter adjustments in the presence of significant tail risks.

[13] As observed in the United Kingdom in the past, debt brakes can lead to procyclicality, requiring larger tightening during downturns, when debt more likely exceeds a threshold. Overly tight corrective actions can encourage circumvention through off-budget activity or extrabudgetary funds.

within three years (Grenada). More stringent correction mechanisms may require remedial action to be included in the next budget. For example, Slovak Republic requires the government to submit a balanced budget in the following fiscal year if debt is three percentage points of GDP or less below the ceiling. In Finland, the assessment of noncompliance is based on fiscal performance either in the current year, the previous year, or over the previous two years. Returning to rule limits after the expiration of an escape clause may necessitate a longer adjustment horizon.

- *Quantifying the magnitude of the correction.* Some fiscal rules require restoring compliance for current deviations, while others call for fully unwinding past cumulative deviations in the corrective mechanism. For example, Switzerland's mechanism accumulates any deviation from the budgeted expenditures in a notional account, requiring the government to take sufficient measures to bring the expenditures within the limit in next three annual budgets if the negative balance in the account exceeds 6 percent of expenditure. Mechanisms in Germany, Grenada, and Jamaica require corrective actions for cumulative deviations. When determining the magnitude of corrections, it is essential to mitigate procyclical effects and avoid excessive tightening during adverse economic conditions.

- *Adjustment measures.* Some countries specify particular measures; for instance, the fiscal rule in Slovak Republic mandates a freeze on public sector wages if debt exceeds 53 percent of GDP, with further spending cuts if debt surpasses 55 percent of GDP. However, many fiscal rules leave discretion to governments, indicating only the process rather than specific measures. In such cases, governments are often required to present a fiscal plan and a compliance report to parliament. The remedial actions can be expressed in quantitative terms (for example, an adjustment of 0.5 percentage points of GDP or magnitudes agreed upon by the European Commission in Poland) or qualitative (formulating an adjustment plan in Switzerland or fiscal measures in Ecuador). Several countries have preemptive triggers that require stronger fiscal actions, such as spending reductions, when debt exceeds certain thresholds but before breaching the anchor levels.

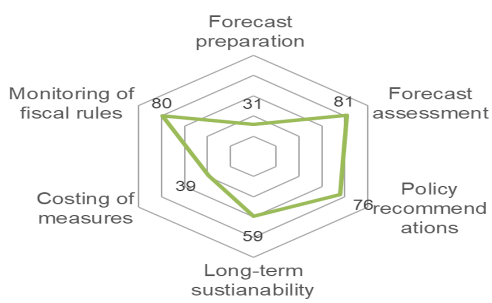
While corrective mechanisms vary across countries, those that are effective share common desirable properties and mitigate the risk of procyclical adjustments. First, the mechanism should be activated based on prespecified conditions (for example, when debt exceeds a preemptive threshold or when fiscal rules are breached) (IMF 2019). Second, while prespecified mechanisms could reduce sovereign risks as shown, their design should be weighed against the risk of procyclical spending cuts when the mechanism is triggered. Third, the mechanism should be enshrined in legislation, such as in a provision within the Fiscal Responsibility Lawand Public Financial Management Law. This provision should outline the procedures for implementing remedial actions and establish reporting requirements. Governments' corrective plans—incorporating concrete measures—should be regularly updated in the MTFF report and presented to parliament.[14] Finally, the pace of corrective adjustments should be aligned with sovereign risks and faster adjustments may be warranted if debt sustainability risks are high. A carefully calibrated pace of corrective adjustment can facilitate a timely return to the fiscal rules while avoiding unintended tightening from abrupt corrections (Gbohoui and Medas 2020). These principles are broadly in line with empirical findings that such mechanisms are supportive to the implementation of fiscal rules and could mitigate sovereign risks (Beetsma and Debrun 2018; Debrun and Jonung 2019).

[14] Corrective mechanisms for subnational governments usually work better when enforced by the central government. For supranational fiscal rules, the corrective mechanism should be overseen by an institution responsible for ensuring the implementation of these rules.

C. Strengthening Fiscal Institutions and Governance

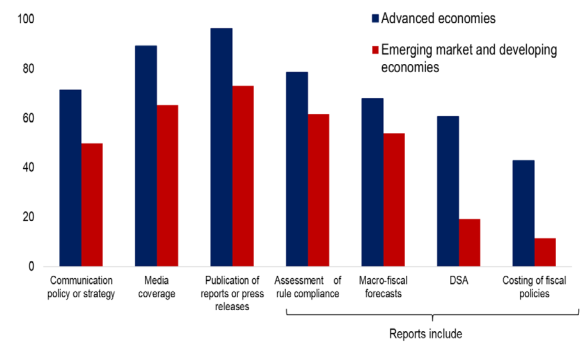
Fiscal rules often fail to achieve their intended objectives because of inadequate supportive fiscal institutions. Fiscal institutions and governance encompass the requirements, processes, and entities responsible for the formulation, execution, and oversight of fiscal policies in public financial management. The absence of robust fiscal institutions and governance contributes to challenges in the functioning of fiscal rules, including overly optimistic macro-fiscal forecasts, poor budgetary control, weak links to MTFFs, and a lack of independent fiscal oversight.

Figure 13. Key Mandates of Fiscal Councils
(Percent of total fiscal councils)



Sources: Alonso and others 2025a; and IMF Fiscal Council database: 2024 Update.

Figure 14. Fiscal Councils—Communication Aspects
(Percent of total fiscal councils)



Sources: Alonso and others 2025a; and IMF Fiscal Council database: 2024 Update.
Note: Media coverage refers to whether fiscal council leadership holds media events or parliamentary hearings. DSA = debt sustainability analysis.

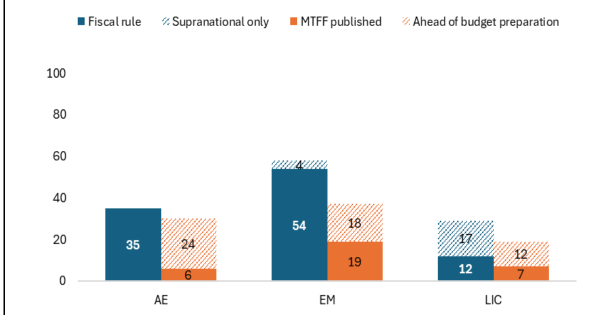
Cross-country experiences indicate considerable scope to strengthen communication and operational independence in fiscal oversight. Fiscal oversight can be a critical component of a risk-based fiscal rule framework (Arnold and others 2022).[15] The core watchdog function—for instance, of fiscal councils—is to monitor the compliance with fiscal rules and assess the reliability of macroeconomic projections (Figure 13). In practice, however, many fiscal councils, particularly in EMDEs, do not effectively communicate their assessment to the public or publish reports regularly (Figure 14). Even among those that publish reports, the content often lacks assessment of forecasts or debt sustainability risks. Some fiscal councils also do not operate independently (OECD 2021) and may face budget shortfalls or political interference.

Supportive fiscal institutions and governance can help countries implement and comply with fiscal rules. Two key areas in fiscal governance should be strengthened:

[15] Additional empirical evidence points to fiscal councils contributing to improved fiscal performance, according to country-specific case studies for Belgium and the United Kingdom (Hagemann 2011; Lebrun 2009; Coene 2010) and cross-country evidence for EU countries (Debrun and Kumar 2007).

- **The preparation of MTFFs should be closely linked to fiscal rules and annual budgets.** The MTFF sets top-down limits on government expenditure and fiscal balance, guiding the annual budget process. The MTFF report should include the fiscal strategy, medium-term macro fiscal projections, measures for achieving fiscal targets, and fiscal risks assessment (Curristine and others 2024). The MTFF should be prepared and published before the budget, incorporating multiyear ceilings for fiscal aggregates, which can also be disaggregated into sector-specific or programmatic frameworks (for example, France, Rwanda, South Africa, Sweden) to facilitate the translation of targets into annual budgets and spending priorities (Figure 15).

Figure 15. Linkages of Fiscal Rules and the Publication of MTFFs, by Income Groups
(Number of countries, 2024)



Sources: Alonso and others 2025a; and IMF Fiscal Council database: 2024 Update. Note: AE = advanced economies; EM = emerging market economies; LIC = low-income countries; MTFF = medium-term fiscal framework.

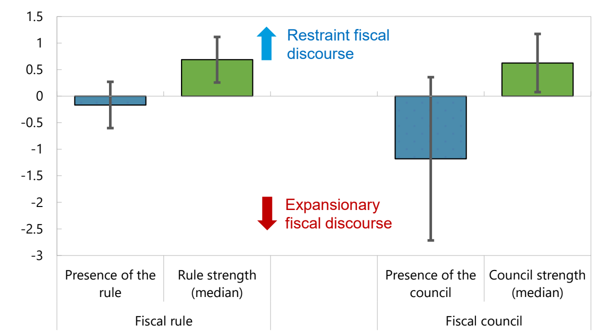
- **Countries should strengthen independent fiscal oversight.** Fiscal oversight can take different institutional forms, ranging from parliamentary budget committees and auditor offices to independent fiscal councils. Fiscal councils can provide technical assessments of compliance with fiscal rules and can alert in-year deviations. Their expertise is critical for evaluating risks to public finances and the realism of macro-fiscal forecasts in the budget and MTFF. Fiscal councils should have direct communication with the media. To secure their operational independence, they should have a well-defined mandate aligned with their resources, budget safeguards, and timely access to information (IMF 2013; Debrun and Kinda 2014; Davoodi and others 2022). However, for many small developing countries, a standalone fiscal council may not be practical due to limited resources and capacity. In such cases, it may be beneficial to leverage existing entities (such as general audit office or parliamentary budget committee) to fulfill oversight functions.

Empirical analysis indicates that strengthening fiscal rules and fiscal councils is associated with reduced deficit bias and stronger fiscal outcomes. Using the latest update of the IMF Fiscal Rules and Fiscal Council databases, empirical analysis explores how bolstering these frameworks using the strength indices may enhance fiscal outcomes across different dimensions (Technical Annex 2).

Strong fiscal rules and councils are associated with greater fiscal restraint in political discourse. Empirical results show that discourse on fiscal restraint—measured by the share of political party manifestos advocating for reduced budget deficits or spending limits—declined on average in countries without fiscal rules or independent fiscal councils between 1990–2009 and 2010–22 (blue bars in Figure 16). Importantly, countries with stronger fiscal rule frameworks or more effective fiscal councils experienced a smaller decline or even an increase in political restraint discourse, by about 0.7 percentage points, compared to countries without these mechanisms, respectively (green bars in Figure 16).[16] Cross-country estimates suggest that stronger rules, rather than the mere presence of the rules themselves, are associated with stronger fiscal restraint among political parties.

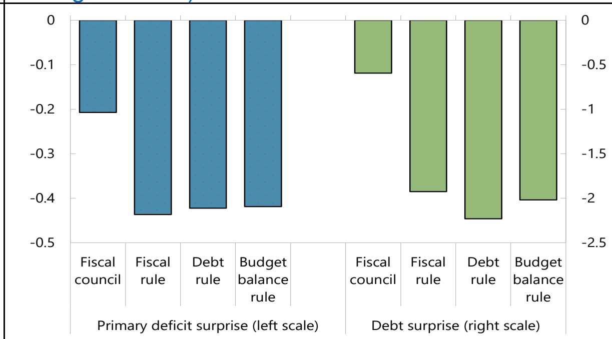
[16] The estimates are in line with the findings in Cao, Dabla-Norris, and Di Gregorio (2024) and Azzimonti, Battaglini, and Coate (2016) that the presence of fiscal rules is not necessarily associated with restraint on pro-spending discourse.

Figure 16. Changes in Restraint Fiscal Discourse and Strength of Fiscal Rules and Councils
(Relative to changes in countries without fiscal rules and councils; 2010–22 compared to 1990–2009)



Sources: Alonso and others 2025a, 2025b; Cao, Dabla-Norris, and Di Gregorio 2024; and IMF staff calculations.
Note: The figure shows estimated changes in average restraint fiscal discourse between 1990–2009 and 2010–22 in countries with fiscal rules (or fiscal councils) relative to those without. Estimates are obtained using two cross-country ordinary least squares regressions, where the dependent variable is the change in average restraint discourse from the Manifesto database. Explanatory variables include the binary variable indicating the presence of fiscal rule (council) and the strength index of fiscal rules (councils). Strength indices for fiscal rules and councils are standardized to range from 0 and 1. Restraint discourse captures the share of party's manifesto's content calling for an outright reduction of budget deficit or the limitation of public spending. The whiskers indicate the 90 and 95 percent confidence intervals of the estimated coefficients for fiscal rules and fiscal councils, respectively. For details see Technical Annex 2.

Figure 17. Fiscal Surprises and Strength of Fiscal Rules and Councils
(Effects on the primary deficit and debt surprises given a change from 25th to 75th percentiles in the selected strength indices)

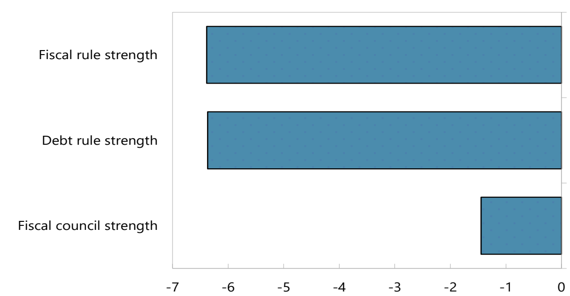


Sources: Alonso and others 2025a, 2025b; and IMF staff calculations.
Note: The figure shows the differential impact on primary deficit and debt surprises when the strength of variable of interest moves from the 25th to the 75th percentile. Strength indices for fiscal rules and councils are standardized to range from 0 and 1. Estimates are obtained using the weighted-average least squares method for 30 advanced economies and 110 emerging market and developing economies during 2000–23 (De Luca, Magnus, and Peracchi 2018), with a panel regression model estimated separately for each strength index. The dependent variables are primary deficit and debt surprises measured as the difference between the actual primary deficit to GDP ratio (government debt to GDP ratio) and that projected one year ahead. A variable is a "robust" contributing factor if the associated *t*-statistic is greater than one in absolute value. Details see Technical Annex 2.

Fiscal rule frameworks and independent fiscal councils can help mitigate excessive optimism in macro-fiscal forecasts. Evidence shows that fiscal slippages, measured by deviations between actual fiscal deficits and projected levels, tend to be smaller in countries with fiscal rules and fiscal councils (Figure 17), supporting earlier findings by Caselli and others (2022). The analysis also indicates that stronger fiscal rules and more effective fiscal councils correlate with smaller deficit and debt surprises (Technical Annex 2). For instance, surprises in primary deficits decline by 0.4 and 0.2 percentage point of GDP when the strength of fiscal rules improves from the 25th percentile (for example, Mexico and South Africa) to the 75th percentile as in Lithuania. This decline in fiscal surprises is nearly twice the size of average forecast errors, and a similar reduction in debt surprises averages 2 and 0.6 percentage points of GDP, respectively, with improvements in strength indices.

Stronger fiscal rules and councils are associated with better compliance with fiscal rules. Using a measure of excessive deviations of debt-to-GDP ratios from rule limits—a proxy for noncompliance, empirical results indicate that countries with stronger fiscal rules are associated with smaller deviations from these debt limits (Figure 18; Technical Annex 2).[17] The analysis shows that an increase in the strength of debt rule from 25th to 75th percentile corresponds to a 6 percent reduction in deviations from debt rule limits (Figure 18). More effective fiscal councils, such as those with budget safeguards or multiyear funding commitments, are also associated with a decrease in excessive deviations from debt rule limits, averaging 1.5 percent of the country's debt-to-GDP ratio. These findings align with existing literature that highlights the relationship between compliance with fiscal rules and the characteristics of fiscal frameworks, as well as economic and political environments (Reuter 2019; Larch and Santacroce 2020; Ulloa-Suárez 2023).

Figure 18. Deviations from Debt Rule Limits and Strength of Fiscal Rules and Councils
(Effects on the deviations from debt rule limits given a change from 25th to 75th percentiles in the selected strength indices)



Sources: Alonso and others 2025a, 2025b; and IMF staff calculations.
Note: The figure shows the differential impact on primary deficit and debt surprises when the strength of variable of interest moves from the 25th to the 75th percentile. Strength indices for fiscal rules and councils are standardized to range from 0 and 1. Estimates are obtained using the weighted-average least squares method for 19 advanced economies and 45 emerging market and developing economies during 2000–23, with a panel regression model estimated separately for each strength index. The dependent variable is the difference between the actual public debt to GDP ratio and the debt rule limit normalized by the country-specific average debt to GDP ratio over the sample period. A variable is a "robust" contributing factor if the associated t-statistic is greater than one in absolute value. See Technical Annex 2.

IV. Should Fiscal Rules be Revised to Address Spending Pressures?

As structural spending pressures intensify, policymakers face a growing trade-off between accommodating priority expenditures and preserving fiscal discipline. Fiscal rules compel governments to prioritize within an overall envelope that ensures sustainability—a necessary condition for durable growth (Wyplosz 2012). Yet some have argued that these constraints may disproportionately affect public investment or other priority spending (Basdevant and others 2020; Vuchelen and Caekelbergh 2010), even though empirical evidence on this is mixed (Larch and van der Wielen 2024; Blesse, Dorn, and Lay 2023). The revision to fiscal rules thus needs to strike the right balance that could provide space for priority spending while maintaining sufficient restraint on fiscal policy to contain sovereign risks. In this context, this section presents a model-based framework to assess whether and how fiscal rules should be adjusted to facilitate additional investment, particularly under varying levels of debt and fiscal space (Technical Annex 3).

[17] Deviations of actual debt-to-GDP ratios from debt rule limits (also expressed in percent of GDP) are standardized across countries by dividing the deviation by the country-specific average public debt-to-GDP ratio calculated over the sample period.

A conceptual model is employed to assess whether and how fiscal rules should be adjusted to facilitate additional public investment. This framework is a dynamic general equilibrium model, extending the work of Traum and Yang (2015) and Mian, Straub, and Sufi (2022). The model features a rich fiscal block, incorporating both public investment and public consumption, as well as tax instruments. In this model, the government faces the risk of debt distress, which increases with debt-to-GDP ratio in a nonlinear and endogenous way (Technical Annex 3). The nonlinearity is critical, which is linked to the initial debt level and enables the model to capture how borrowing costs can rise disproportionately as debt increases. Higher borrowing cost for the government also impacts private sector activity. As a result, the fiscal multiplier is related to the risk of debt distress and the means of financing. Adjusting the fiscal rules would yield different impacts from additional investment due to the way these rules influence how the investment is financed. The model is calibrated to three different economies with distinct debt risk levels: (1) an advanced economy with low initial debt at 60 percent of GDP, (2) a country with limited fiscal space and high initial debt at 110 percent of GDP, and (3) an advanced economy with very high debt at 140 percent of GDP.[18] Fiscal rules are assumed to be binding at the deficit or expenditure ceilings. Households hold government bonds but require a risk premium to be compensated for higher risks in the equilibrium. Simulations consider a 1 percentage point of GDP increase in public investment over a 10-year horizon.[19]

The baseline assumes that the additional investment is financed through debt. Owing to nonlinear higher debt distress risk when debt is high, the same investment profile will yield different effects on output and debt dynamics. The analysis focuses on the first 15 years and assesses if the debt stabilizes or declines at the end of the horizon.

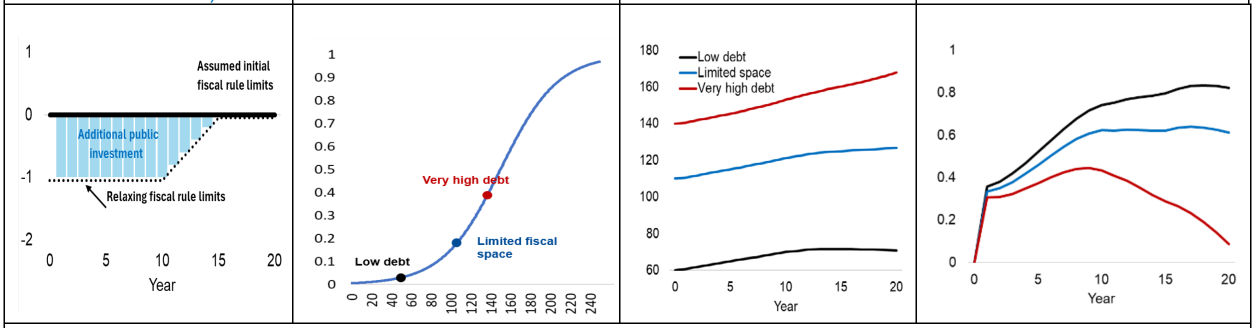
Simulation results illustrate several insights on the design of fiscal rules to accommodate growth enhancing investment.

- **Simulations show that excluding investment from rule limits leads to sharp and persistent increases in debt, especially for high-debt countries.** If additional investment is excluded from fiscal rule limits, debt will continue to rise, even if fiscal rules on deficit or expenditure limits (excluding investment) are adhered to. The extent of debt accumulation depends on initial debt levels, fiscal multipliers, and the risk of debt distress. For high debt countries with limited fiscal space, a higher risk of debt distress is associated with lower output impact from additional investment. Simulations indicate that debt could rise by 15–24 percent of GDP over the next decade without stabilizing, which puts debt sustainability at risk (Figure 19, panel 3). Moreover, such exclusions could incentivize misclassification of expenditures and complicate public debt management. Therefore, for all countries, excluding capital expenditure from the rules or activating the escape clause to provide flexibility for extended public investment is generally not advisable, as debt will continue to rise.

[18] While the model calibrates primarily for advanced economies, it also applies to EMDEs, which typically have a lower debt-carrying capacity, such that the probability of debt distress rises sooner at lower level of debt (Technical Appendix 3). This would suggest smaller initial debt levels for low or high debt for EMDEs.
[19] After 10 years, the investment program gradually declines over the next five years and eventually winds down. The cumulative cost of the public investment program is about 12 percent of GDP over 15 years, with the economy converging toward a path of balanced economic growth and stable debt-to-output ratios.[20] The tightening of the rule limits after the investment program ends could be calibrated to offset the rise in debt-to-GDP ratio that would otherwise occur during the investment phase.

Figure 19. Implications on Fiscal Rules Frameworks of Additional Investment

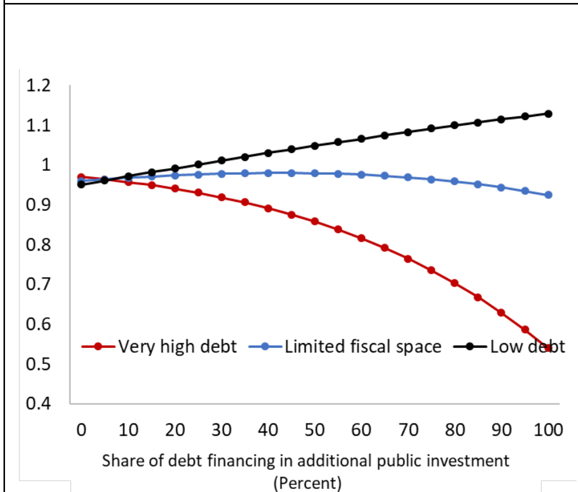
1. Ex Ante Primary Balance (Percent of GDP deviation from baseline)	2. Probability of Debt Distress Rises with Debt (Probability)	3. Debt-to-GDP Ratio (Percent)	4. Output (Percent deviation from the baseline)



Sources: Lam, Nguyen, Sher forthcoming; and IMF staff estimates.
Note: Simulations consider a 1 percentage point of GDP additional investment, from 4 percent of GDP to 5 percent of GDP, maintained for 10 years in using a dynamic stochastic general equilibrium-based model to illustrate three scenarios: (1) countries with low debt or ample fiscal space (black line), (2) countries with limited space (blue line), and (3) countries with very high debt (red line). Additional investment is financed by debt through easing of fiscal rules on expenditure or deficit limits. Ex ante primary balance refers to the budget balance before considering the general equilibrium effects of policy changes. Ex post primary balance will vary slightly due to endogenous changes in output and tax revenue.

- **In low-debt countries, easing fiscal rules modestly to accommodate investment yields sustained output gains with manageable debt dynamics.** Simulations show that endogenous fiscal multipliers are likely higher and positively correlated with the extent of debt financed investment when debt level is low because sufficient fiscal space can avoid a cut in government expenditures (Figure 20). For advanced countries with debt of about 60 percent of GDP, modestly easing fiscal rules to allow additional investment would temporarily increase debt by 8–10 percentage points of GDP, which would eventually return to a downward path over the medium term.

Figure 20. Endogenous Fiscal Multipliers Depending on Financing Means of Public Investment



Source: Authors' illustration.
Note: The vertical axis shows the fiscal multipliers for three different cases with different initial debt-to-GDP ratios across advanced economies. The horizontal axis shows the extent of debt financing in scaling up the same level of public investment (0: no easing of initial fiscal rule limits; 100 means the additional investment is financed entirely by debt by relaxing the rules). An α value between 0 and 1 indicates the proportion 1-α of additional public investment is financed by revenue measures or other spending cuts.

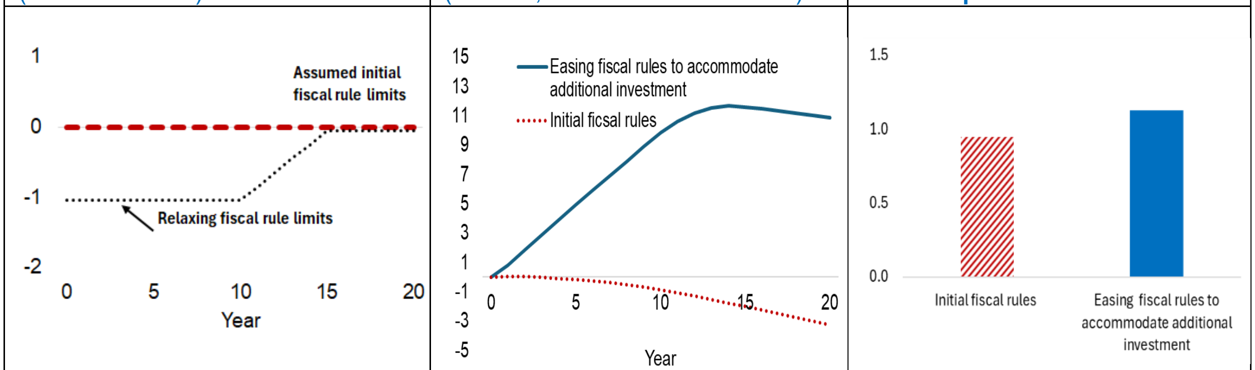
The resulting investment contributes to higher output (with cumulative multipliers above 1.0) (blue line in Figure 21). Interest rates rise modestly as monetary policy tightens to maintain stable inflation. The positive impact on output and stable risk premium keeps the interest-growth differential largely unchanged. Although debt increases in line with the cumulative investment outlays, it ultimately returns to a declining path. Model results indicate that the multiplier effects on output are greater than when additional investment is offset by other measures (Figure 21, panel 3). While these countries can adjust their rules within debt-stabilizing limits, additional investment should align with their capacity to maintain spending efficiency. In practice, adjustments to fiscal rules could include recalibrating the deficit or expenditure limits and/or committing to a higher debt anchor. For example, Germany eased its national "debt-brake" (a structural net borrowing rule) to accommodate higher defense spending and infrastructure investment while debt is projected to stabilize over the medium term.

Figure 21. Effects of Additional Public Investment for Low-Debt Countries with Ample Fiscal Space

1. Ex Ante Primary Balance
(Percent of GDP)

2. Debt-to-GDP Ratio
(Percent, deviation from baseline)

3. Cumulative Fiscal Multipliers

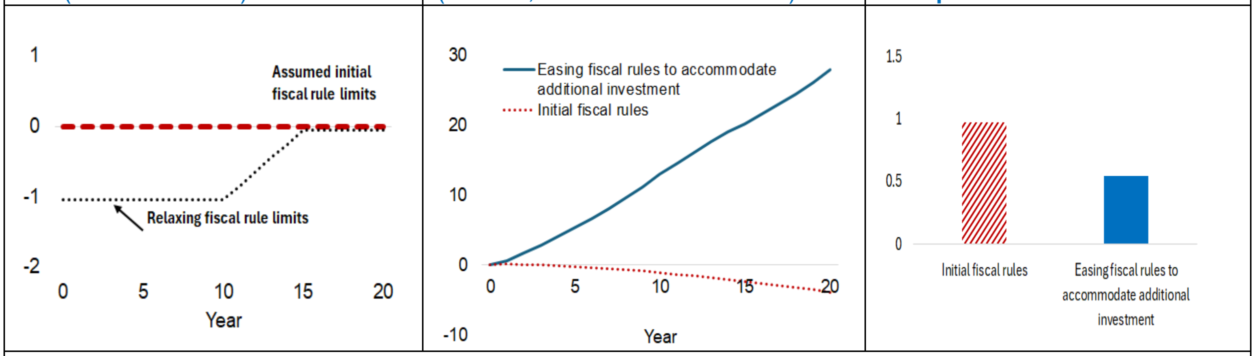


Sources: Lam, Nguyen, and Sher forthcoming; and IMF staff estimates.
Note: The simulation considers a 1 percentage point of GDP increase in public investment maintained for 10 years in two cases. The first case (blue line) shows additional investment is financed by debt through easing fiscal rule limits. The second case (red) shows keeping existing fiscal rule limits and finance investment by cutting other government spending. Ex ante primary balance refers to budget balance before considering the general equilibrium effects of additional investment on output and interest rates, which vary across initial debt levels. Cumulative fiscal multipliers refer to the cumulative change of output relative to cumulative change in investment over a 20-year horizon.

- **In high-debt countries, relaxing rules to allow additional debt-financed investment would lead to rising interest rates, weaker output effects, and unsustainable debt paths.** For advanced economies starting from a debt level of 110 or 140 percent of GDP, additional debt-financed investment would increase debt to GDP ratios by 12–24 percentage points; however. the output gains are much more muted (with cumulative multipliers below 0.5) (Figure 20, panel 2 and Figure 22). Rising interest costs dampen the positive output impact, widening interest-growth differentials and leading to an unsustainable debt trajectory. Furthermore, analysis indicates an inverse relationship between the degree of easing the rule and multiplier for high-debt countries, with the multiplier deteriorating more rapidly as the rule is relaxed further (Technical Annex 3). This emphasizes that easing fiscal rule limits to finance additional investment is not a viable option. Instead, scaling-up investment or other priority spending must be offset through fiscal adjustments, such as raising taxes, reprioritizing expenditures, or enhancing spending efficiency. Maintaining fiscal rule limits is crucial for preserving debt sustainability and supporting economic growth.

Figure 22. Effects of Additional Public Investment for High-Debt Countries

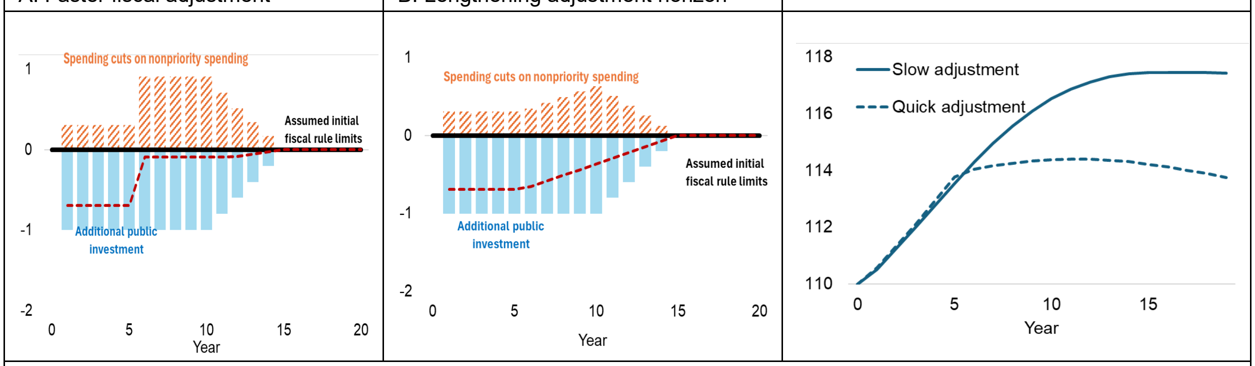
1. Ex Ante Primary Balance (Percent of GDP)	2. Debt-to-GDP Ratio (Percent, deviation from baseline)	3. Cumulative Fiscal Multipliers



Sources: Lam, Nguyen, and Sher forthcoming; and IMF staff estimates.
Note: The simulation considers a 1 percentage point of increase in public investment for 10 years in two cases. The first case (blue line) shows additional investment is financed by debt through easing fiscal rule limits. The second case (red line) shows keeping existing fiscal rule limits and finance investment by cutting other government spending. Ex ante primary balance refers to budget balance before considering the general equilibrium effects of additional investment on output and interest rates, which vary across initial debt levels. Cumulative fiscal multipliers refer to the cumulative change of output relative to cumulative change in investment over a 20-year horizon.

Figure 23. Lengthening Adjustment Horizon

1. Primary Balance (Percent of GDP)		2. Debt-to-GDP (Percent)
A. Faster fiscal adjustment	B. Lengthening adjustment horizon	



Source: Authors' estimates.

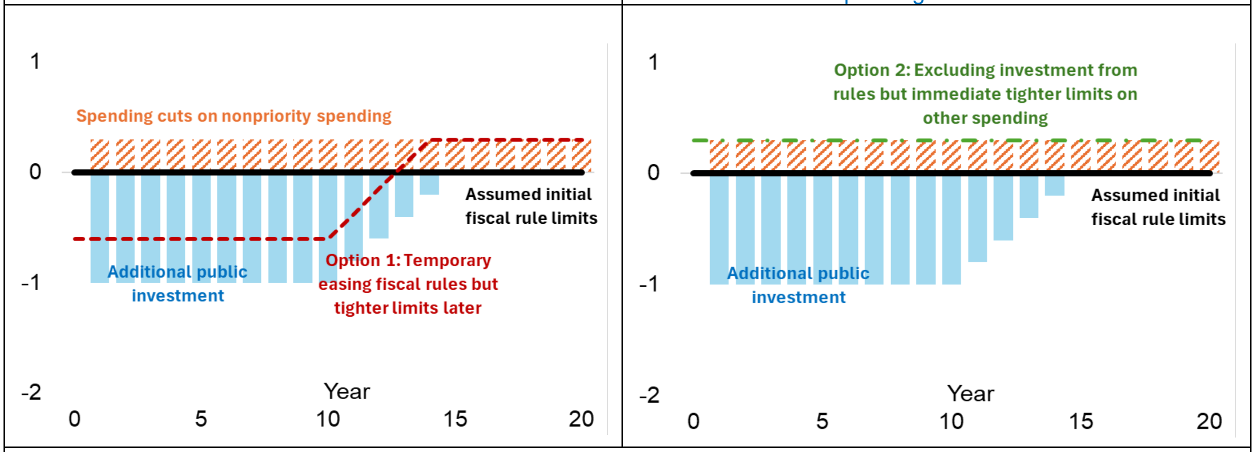
For high-debt countries with limited fiscal space, adjustments to fiscal rules must be carefully calibrated to preserve debt sustainability. Simulations consider two different paces of fiscal adjustments following an initial scaling up of public investment (Technical Annex 3). A faster adjustment would make rules more binding, necessitating cuts in current spending to contain debt, potentially resulting in abrupt reductions in primary spending (Figure 23). Conversely, revising fiscal rules to allow more gradual adjustments may create space for investment, but could heighten the risk of debt distress, especially with high debt levels. Therefore, any extension should ensure that fiscal rules continue to guide policies aimed at maintaining debt sustainability. For instance, the European Union's fiscal framework permits a longer adjustment period (seven years instead of four) if member states use the additional room for growth-enhancing investment and reforms. The longer adjustment horizon is estimated to provide €700 billion in fiscal room between 2025 and 2031 (Bouabdallah and others 2024).

Second, governments can impose tighter rule limits on nonpriority expenditures. This goal can be achieved through: (1) a temporary easing of fiscal rule limits to accommodate investment spending, followed by a tighter limit once the investment program ends (Figure 24, panel 2)[20] or (2) a temporary exclusion in the fiscal rules for the additional investment, paired with a simultaneous tightening of expenditure or deficit limits on nonpriority spending (Figure 24, panel 2) (Zettelmeyer 2025). Both options entail benefits and risks. The first option reduces the scope of misclassifying spending and creative accounting, but the easing of fiscal rule limits could become permanent, potentially leading to a rapid rise in debt if the investment program is extended. The second option allows for an immediate tightening of nonpriority spending but may also create opportunities for misclassification and political interference in prolonging investment programs. In countries lacking oversight or capacity, these options carry large risk of debt buildup without corresponding tighter adjustments in the future.

Figure 24. Illustrative Adjustments to Fiscal Rules to Accommodate Investment Face Merits and Risks
(Ex ante primary balance in percent of GDP)

1. Temporary easing fiscal rules but tighter limits later

2. Excluding investment from rules but immediate tighter limits on other spending



Sources: Lam, Nguyen, and Sher forthcoming; and IMF staff estimates.
Note: Ex ante primary balance refers to budget balance before considering the general equilibrium effects of additional investment on output and interest rates, which vary across initial debt levels. Initial fiscal rule limits refer to the binding expenditure or deficit paths in the original case before considering additional investment.

A clear commitment to safeguarding the integrity of fiscal rules and transparency is crucial. Net expenditures should adhere to previously agreed commitments, and any permanent increases in fiscal outlays financed by mobilizing revenues. While the model primarily considers public investment, similar insights apply to other spending pressures, such as healthcare, pension entitlements, and defense spending. Non-investment expenditures, such as pensions and healthcare, typically do not enhance the economy's productive capacity, suggesting a lower fiscal multiplier compared to public investment. In these cases, the scope for easing fiscal rules to increase non-investment expenditure would likely be smaller. For the same size of additional spending, debt-to-GDP ratio will rise more due to lower output from smaller multipliers and endogenously higher interest rates. Additionally, defense spending, which includes both current and capital expenditures (for example, current expenditures on personnel and maintenance versus capital expenditures on equipment or infrastructure), presents challenges in excluding from rules. Other factors, such as political economy and communication of fiscal plans, also affect governments' credibility, although these factors are not considered in the simulation.

Countries need a comprehensive long-term fiscal strategy to address structural spending. Policymakers should avoid overloading fiscal rules with multiple objectives, as their primary role is to

[20] The tightening of the rule limits after the investment program ends could be calibrated to offset the rise in debt-to-GDP ratio that would otherwise occur during the investment phase.

guide medium-term fiscal policies. Revisions to accommodate higher spending must consider initial debt levels and associated risks. Regular reviews of expenditures against established priorities can uncover efficiency gains, creating space for public investment. Strengthening the public investment management framework—encompassing planning, resource allocation, and implementation—can enhance investment efficiency and facilitate quality public investment within fiscal rules.

V. Conclusions

This Staff Discussion Note revisits the design challenges of fiscal rules and councils, in a world where public finances are under growing strains. In addition to long-standing fiscal challenges such as high debt and rising interest costs, the implementation of fiscal rules has become more challenging in containing deficit bias and guiding fiscal policy. Post-pandemic deficits and debt significantly exceed fiscal rule limits, while countries are facing pressures to scale up defense spending due to rising geoeconomic tensions and to invest in growth-promoting initiatives.

Recent updates from the IMF Fiscal Rules and Fiscal Councils databases indicate progress in the design of fiscal rules and councils, alongside the identification of compliance gaps. As of the end of 2024, more than 120 economies and 50 countries have adopted fiscal rules and established fiscal councils, reflecting a steady increase. Despite gaining flexibility to respond to severe shocks, compliance remains inconsistent, and recent revisions have not improved adherence. Moreover, many fiscal councils operate with a narrow mandate and lack effectiveness in enforcing fiscal discipline, making it difficult for countries to reduce large deficits and debt amid heightened policy uncertainty.

Improving compliance necessitates a multi-pronged approach. New analytical findings suggest the importance of selecting a prudent fiscal anchor within a risk-based fiscal rule framework, tailored to a country's debt-carrying capacity. This approach ensures sufficient fiscal buffers and mitigates the risk of sovereign distress. Moreover, robust corrective mechanisms with predefined triggers, timelines, and corrective measures can be used to guide the return to fiscal rule limits. When designed effectively, these mechanisms can contribute to persistent reductions in sovereign spreads. Well-designed fiscal rules and effective councils are associated with reduced forecast bias and improved compliance.

Strengthening fiscal oversight is also crucial. Fiscal councils should establish direct communication channels with the media through dedicated webpages, press events, and publications, such as reports on fiscal risk, debt sustainability assessments, and the costing of fiscal policies. Additionally, maintaining operational independence and insulation from political intervention is vital. To ensure this independence, fiscal councils need a clearly defined mandate aligned with their resources, budgetary safeguards, timely access to public finance information from the government at no cost, and significant media engagement.

Lastly, adjustments to fiscal rules to accommodate public investment should be carefully tailored to address countries' debt sustainability concerns. Policymakers should avoid excluding expenditures from fiscal rule limits across all countries, which will create incentives for misclassification and push up debt, even when fiscal rules are ostensibly followed. Instead, countries with low debt and ample fiscal space can consider easing overly tight fiscal rules within debt-stabilizing limits to facilitate a gradual increase in public investment. For those with limited or no fiscal space, fiscal rules should prioritize preserving debt sustainability and rebuilding fiscal buffers. As governments focus on growth-enhancing investment and address expenditure efficiency gaps, they will also need offsetting measures when scaling-up growth-enhancing investment, all while preserving the integrity and transparency of the rules.

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