COMMENTS ON SESSION 3:
PUBLIC SPENDING AND FISCAL POLICY MANAGEMENT

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I shall mainly concentrate on the fifth paper of this session: Creel, Saraceno and Monperrus-Veroni's "Dynamic Fiscal Policy in France: The Cases of Public Spending, Taxes and Public Debt". I will also touch on paper 3 on the same issues for Italy and on paper 9 on Japan's fiscal policy.

The French paper is an elegant technical study on a VAR approach to the issue. For instance, I like your thorough account of shocks to the relations.

I am not sure I understand fully the fiscal theory of the price level from this paper, but I understand that I should not worry about this theory, as its impact seems small, judging from your results. Can we add that this theory is also difficult to reconcile with membership of a monetary union where the French price formation will be influenced by the rest of the euro area?

Paper 5 is a paper with an attitude. It stresses the apparently long-lasting negative impact on output of fiscal tightening and welcomes the recent EU summit decision, which softens the Stability and Growth Pact.

I wonder how robust your result is. I am now looking at your Figure 2, upper part, on the surplus shock.

The immediate GDP response seems rather small at first, but it turns big after some years. I would have expected the opposite profile: a rather quick impact on GDP followed by simple crowding out. Especially if you expand public consumption, I would expect some direct impact on GDP, due to the definitional relation. Such underlying definitional relations may, by the way, suffer from a sort of measurement problem if you are working with the fiscal balance as such. The whole balance is not part of GDP.

Moreover, it puzzles me to see the inflation going up, although only marginally, after a fiscal contraction where GDP is reduced in the medium term. This way, the result resembles a negative supply shock.

You relate the medium-term GDP fall to a negative wealth effect. I do not see a clear correlation between wealth and GDP effects in your results, but I think I understand the potential wealth effect you mention. Having wealth in the determination of consumption is like introducing Say's law. If income is not spent in the first quarter it will go into the stock of wealth and impact consumption in the following quarters until it is spent. You have this mechanism creating a delayed negative impact from fiscal contraction to demand.

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I imagine that it will be difficult for you to sell your emphasis on this lagged-wealth effect. Decision makers like fiscal expansions because they promise an immediate positive impact on activity.

Concerning your political conclusions, I think you are going too far. You do not need to be a non-Keynesian to accept the Pact. An honest Keynesian could also accept the pact. By "an honest Keynesian" I mean one who makes sure to reload the fiscal gun by tightening in good times.

I am indeed interested in the longer-term effects on GDP from fiscal expansions, and the French paper shares the VAR approach to this issue with the Italian paper, where the GDP impact of fiscal shocks is rather short-lived. This obviously differs from the results in the French paper. It is often difficult to reconcile VAR results.

Both papers identify a reaction in the interest rate when fiscal policy is changed, but will this link not be weak in a euro framework? The present 10-year interest differentials between euro members do look moderate. If we forget the interest rate reaction for euro members, what do the authors of both papers think about the role of wage flexibility and of the trade channel?

The final paper in this session, number 9, Masato Miyazaki's "Framework for Fiscal Consolidation: Successes and Failures in Japan", gives it to us without mercy. To succeed with your fiscal policy it is not enough to be clever and wise economically and politically. You also need good luck! It is like playing in a cup tournament where you need a bit of luck to win.

Implementing fiscal tightening or structural reforms is so much easier if followed by an economic upturn. With Ireland and Denmark in the eighties as examples, it has been claimed that tightening creates the necessary upturn. Indeed, if you start with a 10 per cent interest differential to what is supposed to be your currency-anchor, you may reduce your interest rate by tightening to make your policy credible. However, today we do not have an interest differential to reduce and neither has Japan, so we need all the luck we can get.

Your paper exemplifies some old lessons like the expansionary bias in fiscal policy. You have also made the positive experience that when problems get serious enough more things get politically feasible. Somehow the world must have been sustainable until now.

I will not question your presentation of Japanese fiscal policy, but I have a question as to the outlook. You note that negative GDP growth in the 2nd and 3rd quarter of 2004 has been followed by positive growth in the 4th quarter, so you are on the path to recovery. That may be an optimistic assumption. Is there a Plan B?