

COMMENTS ON SESSION I: INDICATORS OF FISCAL IMPACT

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Until the mid-80s, the general attitude in the field of fiscal indicators was to develop “the Indicator”, which could be used for almost any purpose, depending on the way it was analysed (levels, first differences, cross-country comparisons, etc.). In the late 80s, Olivier Blanchard, acting as a consultant for the OECD Secretariat, dismissed the possibility of using one indicator as a “jack-of-all-trades” (Blanchard, 1990, p. 5) and raised the following simple preliminary question: “Indicators of what?”. From his analysis it clearly emerged that it was impossible to set up an all-purpose indicator. Instead, each fiscal policy issue would require a specific analytical tool. The main difficulty would lie in finding indicators that make as little use of economic theory as possible. As a matter of fact, fiscal indicators are mostly used by government officials who need simple and robust ways of deriving basic policy statements. Indicators which would heavily rely on a specific piece of economic theory may become vulnerable to criticism by those people who, for any reason, reject that particular theory. International organisations, such as the OECD, the IMF or the EC Commission, would first of all avoid such a risk.

Indicators are designed for supporting the analysis of the following four issues: 1. fiscal impact and/or impulse, namely the short-run stimulus of budgetary policy to economic activity, via its effects on aggregate demand; 2. fiscal stance, or the issue of separating the discretionary component of the policy from the effect of built-in stabilisers; 3. financial sustainability of budgetary policy; 4. fiscal policy effects through distortions, or the effects of tax and spending policies on supply. While it is possible to derive simple indicators for the first three aims, the analysis of fiscal policy effects on the supply side requires a large and articulated set of indicators, heavily dependant on economic theory.

The papers presented in the first session of the workshop cover the first three issues. Apart from providing interesting and accurate analyses,

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they – as a whole, allow to derive some comments on the sensitivity of empirical results to the different methodologies.¹

With respect to the measurement of fiscal impact and fiscal stance, the most controversial issues in the literature are:

1. Do we need the notion of cycle?
2. Can an indicator of fiscal impact be model-free?

As for the first issue, an indicator does not require the identification of a cycle. Information about fiscal stance and impact is usually obtained by analysing first differences of budget balances, purged of the effects of any change in the macroeconomic scenario occurred during the period under scrutiny. As originally pointed out by Blanchard (1990), any arbitrary benchmark suits this need. According to my interpretation, the persistence of the use of the “cyclically-adjusted budget balance” (henceforth cabb) is partly explained by the inertia that large organisations display in changing consolidated methodologies. In recent years, the resurgence of cyclical corrections can be attributable to the introduction of the “stability and growth pact” and the subsequent need to identify the budget balance which would prevent Countries to run a deficit larger than 3 percent of GDP even during recessions. When compared to the “arbitrary benchmark” technique, the main disadvantage of cabb is represented by the need to estimate potential output and its implicit (and often unnecessary) suggestion that cabb can be expected to prevail in the long run – a very ambitious and uncertain statement.²

While Murchison and Robbins apply a new estimating technique to the conventional cabb approach, an application of the “arbitrary benchmark” approach is provided by Philip and Janssen. Their paper includes an interesting comparison of the results derived from their indicator and other ones. The paper by Murchison and Robbins underlines the importance of the estimation techniques to identify the interactions

¹ Obviously, rigorous conclusions would require the application of the different methodologies to a common dataset, which is beyond the scope of the workshop.

² For example, Blanchard *et al.* (1990, p. 33) argue that “the cyclical adjustment is justified only if the economy is going to return to its mid-point fairly quickly; the cyclical adjustment is irrelevant *if the economy is expected to remain depressed for a long time to come*” (italics added). In the light of the long spell of sustained growth of the U.S. economy, it could be added “or if the economy is expected to grow for a long time to come”. As an additional argument against cyclical adjustment, the Authors claim that “cyclical adjustments are not needed when forecasts are available. [...] even for the long-term indicator, a mechanical extension of the forecasts beyond 5 years is likely to dominate any mechanical cyclical adjustment”.

between fiscal policy and the economic cycle. The Authors conclude that when the output gap is large, judgment on policy stance may be biased if the interaction between the business cycle and fiscal policy is not correctly measured.

As for the second issue (can an indicator be model-free), Momigliano and Siviero remind us that fiscal indicators may diverge from econometric simulations. Moreover, model simulations allow to estimate the impact of fiscal policy on several variables (such as prices, balance of payments, employment) and not just output. In the final paragraph, the Authors compare their results with the one obtained by some budget indicators. Their conclusion – based on correlation coefficients among empirical estimates, that “the results appear significantly different, *both quantitatively and qualitatively*, from those obtained using the synthetic budget indicators commonly used to assess the fiscal stance” (p. 1, italics added) is fully warranted. For example, if the definition of fiscal stance proposed by Alesina and Perotti (1995) is adopted,³ model simulations provide a measure of the stance which is different from the one obtained by the Blanchard (1990) and the Ceriani and Di Mauro (1986) methodology respectively 5 and 3 times out of 10. If the comparison is made according to sign consistency, different policy judgements emerge respectively in 1 and 3 cases out of 10. Some discrepancies (4 out of 10, according to the Alesina and Perotti definition) emerge also when comparison is made between the two synthetic indicators. The highest correlation between model simulations and indicators is displayed by the Ceriani and Di Mauro indicator, likely because their methodology attributes different weights to different budget items. On the basis of model simulations, Momigliano and Siviero estimate that 30 percent of the overall effect can be attributed to the changes in budget composition. Thus indicators that ignore any change in the budgetary mix is likely to miss a significant part of the impact.

Denis and Quinet, as well as Mohr, address the highly debated question of the effects of fiscal policy on output. The issue is particularly relevant in EMU-Countries, where a policy instrument different from monetary policy to be used against asymmetric shocks is needed. Denis and Quinet reminds us that the issue is still quite controversial, as proved by the expansionary effects of an apparently restrictive budgetary policy

³ Fiscal stance is neutral if the effect of fiscal policy on GDP lies between -0.5 and 0.5 percent, loose (tight) between -(+)0.6 and -(+)1.5, very loose (tight) if it is greater than -(+)1.5.

enacted by countries with unsustainable debt.⁴ More generally, the analysis seems to suggest that, while simple indicators can be of some use for assessing fiscal impact (but the issue then becomes: are first round effects of great importance for assessing the appropriateness of fiscal policy?), the estimation of the long-run effects requires not only econometric model simulations (as suggested by Momigliano and Siviero), but also judgements on country-specific qualitative aspects, such as announcement effects. Qualitative judgements appear unavoidable as long as the economy is affected by structural reforms.

Last, but by far not least, Vanne as well as Murchison and Robbins (in the second part of their paper) address the issue of the correct interpretation of point estimates. Because of the uncertainty that always surrounds empirical results – due to sampling errors (Murchison and Robbins) or to the sensitivity of the methodology (Vanne on Generational Accounting), full reliance on point estimates may lead to an incorrect assessment of fiscal policy. I find the innovation of applying stochastic simulations to indicators very useful: this is particularly the case with Generational Accounting, as its empirical results are known to be quite sensitive to the assumptions concerning the long run macroeconomic scenario (see, for example, Banca d'Italia, 2000).

Summing up, the papers seem to suggest that indicators aimed at assessing relatively simple economic phenomena can be developed. However, results may be substantially different according to the methodology that is used or when compared with model simulations, even when the analysis is limited to fiscal impact. As long as an econometric model is available, counterfactual simulations seem to be preferable to any synthetic measure derived from indicators. A delicate issue arises when an econometric model is not available: should policy conclusions heavily depend on indicators? In any case, detailed analysis based on economic theory remains unescapable when judgments on more complex phenomena have to be derived.

⁴ On this point see, for example, Perotti (1999).

ADDITIONAL REFERENCES

- Banca d'Italia (2000), *Fiscal Sustainability*, Rome.
- Blanchard, O. (1990), "Suggestions for a New Set of Fiscal Indicators", OECD Department of Economics and Statistics Working Papers, No. 79.
- Blanchard, O., J.C. Chouraqui, R.P. Hagemann and N. Sartor (1990), "The Sustainability of Fiscal Policy: New Answers to an Old Question", OECD Economic Studies, No. 15, pp. 7-36 (also available as NBER Reprint No. 1547).

