COMMENTS ON SESSION II: FISCAL STABILISATION

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Together the papers in this session provide a useful base for thinking about fiscal stabilisation. I would like to thank the authors for providing useful insights and some stimulating ideas. To place structure around my comments I have sorted the six papers into three broad groups:

1. Empirical analysis of the effects of fiscal policy. Comley, Anthony and Ferguson investigate the effects of fiscal policy on private saving and interest rates in Australia. Steindel looks at US fiscal policy and consumer spending. In a cross-country exercise, Hemming, Mahfouz and Schimmelpfennig look at the link between fiscal policy and activity during recessions.
2. Sitting somewhat on its own, but nonetheless providing useful context for the third grouping is the paper by Eckefeldt and Fischer on government preferences for the provision of stabilisation in the EMU.
3. Macroeconomic modelling approaches to stabilisation in the EU. Meyermans uses simulations with the NIME model to examine automatic stabilisers in the euro area. Barrell, Pina and Hurst consider fiscal target, automatic stabilisers and their effect on output under the stability and growth pact.

The coverage of the papers encompasses individual countries (Australia and the US), a currency union (the EU) and a wider cross-country sample of advanced economies. There is also a mix of techniques, from the event study approach applied to the US, macroeconomic models in the case of the EU, time series error correction models for Australia and cross-country regression analysis for the advanced economies.

Comley, Anthony and Ferguson view the offset to private sector saving as a key variable in considering both the effectiveness of short-term fiscal stabilisation as well as long-term structural budget changes. In the

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New Zealand context there has been a reasonable degree of casual empiricism surrounding the possible link between sustained government fiscal surpluses (since 1994) and household saving rates (which have declined). What is clear from the New Zealand case, and a focus of the Australian paper, is that a number of other factors can be playing a part (e.g., financial liberalisation). In terms of long-term budget changes, the reaction of private saving is an important consideration in the assessment of New Zealand's approach to partially pre-funding future public pension costs. (Issues surrounding the desirability of "conserving and investing" fiscal surpluses are usefully summarised in the Session IV paper by Jagadeesh Gokhale).

The paper by Steindel takes us back to one of the key thoughts in Blanchard's often quoted piece on fiscal indicators (Blanchard, 1993, p. 317) – that to consider fiscal impact requires the use of theory and the relevant theory is the theory of consumption. Early on the paper contains a reference to President Johnson's proposal to grant the executive limited authority to change tax rates for stabilisation purposes. I will briefly return to this thought in the context of institutional arrangements. I found the detailed descriptive event study approach in the Steindel paper refreshing and a useful complement to some of the techniques covered in Session I. Steindel's analysis presents some interesting puzzles and consistently highlights the importance of distinguishing between temporary and permanent policy changes.

Hemming, Mahfouz and Schimmelpfennig also employ episode analysis, although this time in the context of fiscal policy and recessions across a sample of advanced economies. They conclude that the results from their descriptive and regression analysis are not particularly informative in terms of establishing a clear understanding about the role of fiscal policy during recessions. Nonetheless, the four points they raise in the conclusion seem like the right questions to asking in terms of further research.

Finally, the last three papers share a common theme in terms of their focus on the EU and the Stability and Growth Pact (SGP). In the Eckefeldt and Fischer paper the supply aspect of fiscal stabilisation includes automatic stabilisers and discretionary policy. To the extent that automatic stabilisers are a function of the tax system, benefit design and the overall size of government, then supply may be problematic. Recent papers on automatic stabilisers are relevant here (van den Noord, 2000; Auerbach and Feenburg, 2000). Eckefeldt and Fischer argue that the EU framework is in "uncharted territory" in regards to the short-term macroeconomic regime and also in terms of longer-term budgetary challenges posed by population ageing. They note that there may be limited scope to increase the role of automatic stabilisers without trade-offs in terms of increasing the tax burden. This again highlights the discussion in Session I about the relationship between structural policy and automatic stabilisers.

The papers by Meyermans, and Barrell, Pina and Hurst, approach the issue of automatic stabilisers and fiscal stabilisation through the use of macroeconomic models. The Barrell, Pina and Hurst paper raises questions about the role of public investment in the SGP. Questions about public investment, often motivated by possible links to long-term growth rates, seem to feature in most fiscal frameworks (including the UK and New Zealand). The paper may have benefited by setting out some of the hypothesised links between public investment and growth.

The two modelling papers, as well as Eckefeldt and Fischer, consider the effect of aggregate demand and aggregate supply shocks on automatic fiscal stabilisers. What does not come through in the papers is a sense of decision making under uncertainty and how this might influence the degree to which authorities allow the "unqualified" operation of automatic stabilisers. In his comments on Session I, Nicola Sartor emphasised the large confidence intervals around estimates of potential output and hence the underlying structural fiscal position. This raises the policy question as to whether it is possible to put in place institutional or budget setting processes that generate a robust fiscal policy reaction function – one that minimises the chance of misjudging structural changes and so locking in structurally higher policy changes that will need subsequent reversal. The institutional design around active fiscal stabilisation policy raises questions about the relevance of so-called Independent Fiscal Authorities (IFAs).

In New Zealand, co-ordination between monetary and fiscal authorities does not take the form of the authorities acting to pursue joint policy objectives. Rather, fiscal policy and monetary policy are co-ordinated by putting each within medium-term oriented framework that emphasises well-defined objectives and transparency. Fiscal policy needs to take account of the likely monetary policy reaction and vice versa.[1]

[1] See the Reserve Bank of New Zealand submission to the Independent Review of the Operation of Monetary Policy, supporting document on "Fiscal and monetary coordination" (www.rbnz.govt.nz/monpol/review). The monetary policy review contains a useful summary on (continues)

There is also active consultation between New Zealand's monetary and fiscal authorities on major policy changes, as was the case during the tax reductions of the mid-1990s. Although this type of arrangement seems reasonably well suited to New Zealand (and given obvious institutional similarities, the UK), the advantages and disadvantages of an IFA may differ within arrangements such as the EU. This is acknowledged in the Lindh and Ohlsson paper in Session IV, where the role of fiscal policy institutions is considered for Sweden.

the co-ordination of monetary and fiscal policy given the transparency and medium-term orientation of New Zealand's macroeconomic policy frameworks (Svensson, 2001).

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