

**COMMENTS ON SESSION IV:  
FISCAL POLICY ISSUES IN ECONOMIC AREAS AND  
COUNTRIES**

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**1. Introduction**

The interesting papers presented in this session all discuss important aspects of fiscal policy based on specific country experiences. In my view the papers raises three main themes: Fiscal policy and stabilisation policy, fiscal sustainability and the structural aspects of fiscal policy.

**2. Fiscal policy and stabilisation**

As expressed by Nakao the experience of the Japanese economy suggests that the ability of fiscal policy to affect economic activity even in the short term is not as strong as the textbook IS-LM model would suggest. The Danish experience also suggests that fiscal policy might not always work as keynesian theory tells us. From 1982-1986 a massive fiscal tightening took place in Denmark. However, the tightening led to a significant boom in private consumption and investment.

The Japanese and Danish experience is clear evidence that when fiscal contractions/expansions affects the overall credibility of fiscal policy, non-Keynesian effects can be quite strong.

Lindh and Ohlsson raise the important question of how national fiscal policy should be conducted in an currency union. The authors suggest that one should choose in advance an instrument that (i) has minimal distributional effects and (ii) does not have large effects on economic efficiency. Based on the Danish experience the second point is a bit surprising. Indeed, some of the most significant structural reforms has been passed through parliament as measures that should reduce aggregate demand and hence reduce the risk of overheating (and not as structural measures). The deductibility of the interest expenses has been reduced

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dramatically, green taxes have been introduced and compulsory savings schemes, that raises national savings, has been enacted.

### **3. Fiscal sustainability**

The public debt has increased and is still increasing dramatically in Japan. Hence, fiscal policy in Japan is not sustainable measured by conventional measures. However, Nakao argues that the low interest rates suggest that the market expect that the Japanese economy will return to a more sustainable path soon. However, it should be stressed that a low interest only indicates the absence of any significant default risk and does not necessarily imply that fiscal policy is expected to become sustainable soon.

In sharp contrast to the Japanese experience, the public debt in the US and Australia has been reduced dramatically. In Australia this has according to Robinson meant that further debt reduction no longer appears a policy objective.

However, as pointed out by Gokhdale, a complete elimination of public debt can give rise to some problems related to the functioning of the capital markets. These problems can potentially be alleviated by allowing public agencies to hold private financial assets. Gokhdale is skeptical of such an arrangement as there can be a potential deadweight loss from having public agencies having large holdings of private assets. *In principle*, there is clearly a danger of such losses. However, I doubt whether *in practice* these deadweight losses constitute an important problem. At least the experience of Nordic countries such as Norway, Sweden and Finland suggests that it is possible to have large public funds that perform quite well. In Denmark we have the supplementary, public pensions scheme ATP, that was started back in 1964. The fund currently has assets amounting to 25 percent of GDP and hence owns a significant share of many large Danish firms. The board consists of persons from trade unions and employers organisations together with independent experts and government officials. In order to avoid deadweight losses the board is obliged by law to seek the highest possible return (taking into account risk, of course). The fund has performed very well in terms of return on the portfolio. According to Herbertsson, Orszag and Orszag (2000) “there has been little evidence of political interference with asset management decisions”. Furthermore, the administrative costs are very small and far smaller than in private pension schemes. Indeed, the ATP is so efficient that it provides administrative services to private occupational schemes.

#### **4. Structural aspects of the fiscal policy**

As expressed nicely by Balassone *et al.* it is important after decade of fiscal consolidation to shift focus towards the microeconomics of fiscal sustainability.

Robinson argues that there is a conflict between fiscal consolidation and raising the productive capacity of the economy. In Australia and other countries, politicians, eager to improve public finances, has cut back on public investment that is crucial to long-run growth. This is surprising, given that economic theory tells us that public investments does not affect long-run sustainability provided that the return on the investment is equal the market return.

There clearly is a danger of public investments is being squeezed too much. However, a significant share of public investments cannot pass a cost-benefit analysis. For instance, in Denmark many investments in infrastructure projects are a result of intensive regional lobbying and do not reflect cost-benefits considerations. Hence, we should be cautious about saying that public investment does not affect fiscal sustainability.

One way of raising the growth potential without affecting fiscal sustainability is to do revenue-neutral tax-reforms. Balassone *et al.* give a very informative description of the reforms of the Italian tax system in recent years. Their analysis suggests that the reforms have so far not reduced the distortionary effects significantly. The Danish experience suggests a more mixed conclusion. Several reforms have been enacted in the last 15 years. The reforms have been very successful in making the taxation of capital income far less distortionary. However, in terms of reducing the marginal tax rates on labour income the reforms has been far less successful, see Ministry of Economic Affairs (2002). This is partly due to the rise in local income taxes. However, it also reflects that the base-broadening reforms have meant that many persons have shifted to higher tax-brackets.

**REFERENCES**

- Herbertsson, T.T., J.M. Orszag and P.R. Orszag (2000), *Retirement in the Nordic Countries*.
- Ministry of Economic Affairs (2002), *Growth Determinants in The Danish Economy*, August.