COMMENTS ON SESSION 2: DISCRETIONARY POLICY AND FISCAL IMPACT

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1. Comments on "Which Figures to Look: Confusion Over Various Fiscal Indicators" by Masato Miyazaki

The paper aims at an evaluation of several, debt-related indicators to assess the sustainability of public finances. Thereby the author does not deal with long-term fiscal sustainability in a forward-looking, long-term perspective as taken by the OECD or the European Commission, which have been dedicating special attention to the long-term implications of current budget policy and budgetary decisions in recent years (see, e.g., Blanchard *et al.*, 1990; Franco and Munzi, 1997; OECD, 1998). The paper rather focuses on the short-term dimension of fiscal sustainability and on two questions in particular: First, how large is the "true" current overall indebtedness of an economy's public sector and what are its implications for the short-term sustainability of public finances? Second, how do the (differences in) definitions which are underlying the indicators used to evaluate a country's short-term fiscal sustainability limit their informational value and their intertemporal as well as international comparability?

The issue of the paper is a very policy-relevant one. Ensuring the sustainability of public finances is one of the greatest challenges for policy-makers today. That fiscal sustainability has become a concern for more or less all industrialised countries is not only due to the "sins" committed in the past, which now burden present and future public budgets (e.g., running deficits in economically good times or using budget surpluses to increase public expenditures instead of paying off public debt). It is also upcoming long-term developments, particularly the growing demographic pressure practically all industrialised countries will be confronted with in the next decades, which endanger the sustainability of their public finances.

One dimension of fiscal sustainability (which is in the focus of this paper) is the current indebtedness of the public sector, *i.e.* the short-term sustainability of public finances. To assess fiscal sustainability and the "true" indebtedness of the public sector, adequate indicators are needed. "The" indicator of short-term fiscal sustainability does not exist, but there are several "consensual" indicators to capture an economy's indebtedness, the most important of which are the public deficit and the public debt in relation to GDP. In practice, however, the use of these indicators poses two problems: Firstly, the concrete construction of these indicators, and secondly, the data which are to be filled in (the latter strongly depends on the

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definition of the public sector, which – with extra-budgetary units and spin-offs gaining in importance in many countries – is increasingly becoming a non-negligible aspect).

The author considers three indicators and potential problems associated with their construction, the data to be filled in, and their interpretation: the public deficit, the public debt, and national balance sheets. The latter are particularly interesting, as only a few countries use them and accordingly practical experience is relatively scarce; based on the Japanese example the paper gives an insightful impression of the usefulness and limitations of national balance sheets.

The discussion of the paper will concentrate on two points: a methodological one and a more fundamental one, which concerns the scope of the exercise undertaken in the paper.

Firstly, the choice of appropriate and meaningful indicators for an economy's fiscal/budgetary situation depends on the question one is interested in. The question Miyazaki tries to answer is the "true" current indebtedness of the (Japanese) government and the short-term fiscal sustainability of public finances. His starting point is a very important one, the more as it is often neglected in the pure economic debate: namely, that the correct answer to the question of the overall indebtedness of the public sector is important from a democratic point of view. The taxpayer should get comprehensive and reliable information about the government's liabilities for which s/he is supposed to pay eventually, also to be provided with a sufficient informational basis for his/her election decisions. However, the indicators Miyazaki suggests to evaluate the short-term sustainability of public budgets may give an incomplete answer to his question. The indicator "yearly public deficit", for example, might be distorted by cyclical fluctuations or one-off measures (e.g. revenues from privatisation); in this case it would not give a correct picture of short-term fiscal sustainability. For this reason the public deficit figure as the simple balance of revenues and expenditures should be complemented by calculating a structural public deficit, as the European Commission and the EU member states do in their annual stability programmes, for example, to account for short-term economic or political factors which may produce an overly optimistic or pessimistic picture of the actual current state of public finances.

Secondly, Miyazaki's indicators neglect future developments. In addition to being correctly and fully informed about the government's current liabilities, the taxpayer should be "warned" about future burdens for the public budget. Therefore it is not only today's "explicit" debt which is relevant, but also the so-called implicit debt (*i.e.* total debt including discounted future net expenditures) and the expected future debt levels assuming unchanged policies and legislation, respectively. Despite the theoretical and empirical shortcomings of the methodology used to determine future debt levels (see, e.g., Franco and Munzi, 1997), and although the projections must be viewed with the more caution the farther they reach into the future, projected future debt levels may well serve as one useful orientation for policy-makers trying to overcome the myopic orientation which often characterises budget policy. A look at the projected debt levels in percent of GDP for 13 selected

Table 1

Projected Debt Levels for Selected EU Countries up to 2050
(percent of GDP)

Country	2004	2010	2030	2050
Czech Republic	38.6	54.8	140.8	447.1
Germany	65.5	73.6	91.0	138.7
Greece	110.5	105.2	202.4	562.8
France	64.8	70.3	158.4	383.3
Italy	106.0	99.1	119.8	218.0
Cyprus	73.8	72.2	125.5	253.8
Latvia	20.1	23.8	40.3	115.9
Luxembourg	5.0	11.2	49.7	104.0
Hungary	57.3	57.8	77.9	119.9
Malta	73.2	89.8	177.0	286.3
Netherlands	56.3	55.8	98.9	195.4
Slovenia	30.2	28.0	54.2	229.3
Slovak Republic	43.0	49.0	76.5	153.8

Source: European Commission (2005).

EU countries up to the year 2050, as determined in a recent publication by the European Commission (2005), should make this point clear.

These projections illustrate quite drastically that even countries which would be considered as having sound public finances based on their current debt levels and which seem to dispose of a large safety margin, as Latvia or Slovenia, are exposed to considerable future budgetary risks which date back primarily to demographic changes leading to a rapid growth of pension and health care expenditures. These few examples show that it is indispensable to complement the short-term perspective by a long-term one to arrive at a meaningful and comprehensive picture of a public budget's fiscal sustainability.

2. Comments on "Identification of Fiscal Policy Shocks in Chile and Colombia" by Jorge E. Restrepo and Hernán Rincón

Also this paper deals with a very topical issue which is highly relevant for policy-makers. The authors identify the effects of fiscal shocks (variations in public expenditures and/or taxes) on real GDP and analyse the relationships between taxes,

expenditures, and real GDP for Chile and Columbia in comparison. Both the topic and the methodological approach the authors use are inspired by a recent analysis by Blanchard/Perotti (2002), which brought about a number of related country-specific studies during the last few years.[1]

Rather than focusing on the technical features of the kind of analysis as it is conducted in the paper, the following discussion concentrates on some of its more general aspects and implications.

Several aspects and strands of the current debate about the adequate design of fiscal policy and its effects form the background of the analysis carried out in the paper. Firstly, there is increasing doubt among economists and policy-makers about the positive effects of expansionary fiscal policy on GDP: concerning the size of these effects, their duration and sustainability (are they permanent or transitory only?), and the effectiveness of discretionary measures and/or automatic stabilisers in general. Secondly, there is a dispute about the (short- and long-term) effects of fiscal consolidation on growth, particularly with regard to negative expenditure shocks: the traditional Keynesian view of negative effects of consolidation measures is countered with the expectation of "non-Keynesian effects" that would allow for expansionary fiscal consolidations (see the seminal paper by Giavazzi/Pagano, 1990).[2] Thirdly, the debate on the "quality of public finances" initiated in the beginning of this century by the European Commission as one element of the so-called Lisbon strategy to foster growth and employment in Europe plays a role: namely the question whether the potential growth effects of (variations of) fiscal policy measures differ between different categories of spending and taxes.

One of the most interesting results of the work done in the paper is that fiscal shocks appear to have very different effects on real GDP in Chile and Columbia, as Table 2, which summarises the results of the empirical analysis, shows. Also the relations between taxes, public spending, and real GDP are not identical in the two countries analysed in the study.

These findings bring up the question how these sizeable differences in the effects of fiscal policy shocks in Chile and Columbia can be explained. The different results for Chile and Columbia point to the importance of structural economic and fiscal country-specific characteristics which cannot be captured within the estimated models, but seem to have a significant impact on the effectiveness of fiscal policy. In what follows some country-specific factors which might explain the observed differences between the two countries are considered briefly:

- The type of taxes involved in a shock to taxes (direct versus indirect taxes; social security contributions) should be a decisive determinant of the tax shock's effectiveness, due to different incentive effects connected with different tax

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[1] See also the studies by Rezk, Avramovich and Basso on Argentina and by Claus, Gill, Lee and McLellan on New Zealand in this volume.

[2] For a review of recent theoretical and empirical studies on non-Keynesian effects of fiscal policy see Hemming, Kell and Mahfouz (2002), or Prammer (2004).

Table 2

Effects of Fiscal Policy Shocks in Chile and Columbia in Comparison

	Chile	**Colombia**
1 peso increase in tax revenues	–38 cents real GDP (transitory)	no effect on real GDP
1 peso increase in public spending	+1.9 pesos real GDP (transitory)	+12 cents real GDP (transitory)
relation between real GDP, taxes, and public spending	shocks to spending and GDP increase taxes shocks to taxes and GDP do not increase public spending	dependent on the model estimated

categories or because different types of taxes impact on different macroeconomic aggregates. The relation between GDP and taxes should depend on the structure of the tax system, more concretely: the direct-indirect-tax-mix, as individual tax categories react differently to variations in GDP.

- The structure of government expenditures ("productive" versus "non-productive" expenditures or public consumption versus public investment) and the variation of different expenditure categories should have different effects on real GDP.
- The degree of openness of the economy experiencing a fiscal shock, particularly the level of the import ratio, should also play a role: the higher the import ratio, the smaller the real GDP effect of additional public expenditures and the larger the spill-overs to the trading partners.
- Finally, it is plausible to assume that the general economic conditions ("trust" and expectations of private households and firms; the general investment climate) influence the positive or negative effects of fiscal policy shocks: tax increases, for example, should be more harmful in an economic environment which is characterised by unfavourable expectations with regard to the future economic development.

These short deliberations lead to a number of questions worthwhile to be explored within future research in this very interesting field. Firstly, the effects of different tax and spending categories on real GDP should be explored more systematically. Then there is the issue of "pure" (discretionary) fiscal policy shocks compared to the effects of automatic stabilisers built in into the tax and welfare system: for example, an analysis for Germany shows that the pure discretionary policy effect is significantly smaller than the effect including the endogenous working of the automatic stabilisers (Höppner, 2002). Of interest is also the question whether the effects of positive fiscal policy shocks compared to the effects of negative ones are symmetric or asymmetric: do the GDP effects of tax increases and decreases, for instance, just have reversed signs, or do they also differ in size? It

would also be interesting to identify the influence of political and institutional factors (the party in power, the existence and design of fiscal rules, etc.) on the relation between expenditures, taxes, and real GDP: the authors themselves point out the sound fiscal policy in Chile as a possible explanation for the absence of a positive correlation between shocks to taxes and GDP on the one hand and public spending on the other hand. Finally there is the question if and how the results of this type of analysis can be reconciled with work done on the links between fiscal policy and medium-/long-term growth (see, e.g., Bleaney, Gemmell and Kneller, 2001). Trying to get more answers to these questions and to get a clearer and less unambiguous picture than we have now concerning the question what fiscal policy can and should (not) do is an indispensable precondition for deriving clearcut policy implications and recommendations.

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