COMMENTS ON SESSION 4:
THE ROLE OF INDICATORS IN FISCAL POLICY

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It has been rewarding to read the two papers in this session I have been asked to discuss. Both papers give interesting insights on fiscal indicators. However, the papers are quite different in scope.

Moulin and Wierts show that there is a divergence between the budgetary commitments taken by member states in their stability and convergence programmes and the policies actually implemented. As a consequence, objectives become ”moving targets”. One aim of the paper is to find explanations for such behavior.

Boije and Fischer discuss different variants of fiscal indicators with the purpose of measuring structural budget balances and cyclically-adjusted balances on one hand and indicators of fiscal stance and fiscal impulse on the other. As an example, they analyze variants of such indicators used by different institutions to analyze Swedish fiscal policy. Because of the differences in the scope of the papers, I find it convenient to separate my comments on them.

Discussion on "How Credible Are Multiannual Budgetary Plans in the EU?" by Laurent Moulin and Peter Wierts

Moulin and Wierts analyze in a careful manner the budgetary slippages with respect to the plans outlined in the stability and convergence programmes. They compare the intentions expressed therein with their relative *ex post* outcomes. Their main question is whether these slippages depend on a failure to implement the measures planned or on a forecast bias concerning economic growth.

In part three of the paper, the Authors point out in an illustrative manner that plans to achieve the target of a "close-to-balance" budget have in many cases not materialized and that, in their programmes, member states had planned to improve general government balances by ¼ percentages points of GDP on average and by ½ percentage points of GDP in countries with high initial deficits. Moreover, they find that:

- planned measures concern, in most cases, the expenditure side,
- plans have a tendency to backload reductions in deficit, and
- macroeconomic assumptions have been ambitious.

However, the comment on expenditure cuts having expansionary effects (the so-called "non-keynesian effects") is a bit far-fetched in this context. According to my reading of the literature on fiscal policy effects, such mechanism works in the

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case of very serious fiscal crises, when the credibility of fiscal (and/or monetary) policy is completely lost. Examples of this can be found in the deep crises suffered by some European countries in the early 1990s. Even if some member states had problems in fulfilling their obligations under the Stability and Growth Pact, the crises under scrutiny have not been that deep.

Why are objectives missed?

Most of the slippages have occurred on the expenditure side. It is also an interesting finding that tax cuts have, on average, been lower than planned and that growth was overestimated and inflation underestimated, especially for countries with poor initial conditions.

A simple explanation

A possible explanation, not mentioned by Moulin and Wierts, for the finding that fiscal policies have not been as ambitious as planned, could be that the “plans” for later years in the time horizon, *i.e.* for $t + 2$ and $t + 3$, should not be seen as strictly such, nor should they be seen as forecasts. Instead, for some countries they represent calculations based on current policies. At the year $t + 1$, new measures are normally decided for the year $t + 2$, and in $t + 2$ new measures are added for $t + 3$. This simple explanation could contribute to the results and its implications could be analyzed further.

Possible extension or further research

The comprehensive data set that Moulin and Wierts have compiled could be used for further tests and research. One possibility could be to test whether the differences between programmes and outcomes reflect differences in the robustness of the fiscal framework of each member state. In particular, one could test the fulfillment of plans against the strictness of expenditure ceilings. In such a test it would be interesting to evaluate whether the volatility of surpluses derives from the revenue or the expenditure side. A plausible hypothesis is that in member states which have implemented expenditure ceilings, public expenditure has been less volatile and the overshooting has been smaller than in member states with weaker rules. Another way of action could be to test if expenditure slippages are related to election years or not.

Discussion on “Fiscal Indicators in a Rule-based Framework: The Case of Sweden” by Robert Boije and Jonas Fischer

The added value of the paper lies in its clear discussion and comparison of different types of indicators for structural net lending, fiscal stance and related indicators. For me it is of special interest that Swedish data on public finances are used by the Authors as an example. But the discussion is general and valuable also for readers without this special interest.

I find the description in part one of the Swedish budgetary framework, with its virtues and problems, appropriate and in line with that in the article that I co-authored with Urban Hansson Brusewitz and that was presented in the 2005 workshop. I have only two remarks:

- In the Swedish system, annual targets are set for each year to support the overall target. These targets are motivated in the Budget Bills in relation to the cyclical situation of the economy and the current position of net lending compared to the overall target, although no strict formal rule is used. The annual targets for the coming year were introduced in 2003.
- About the relation between the surplus target and the expenditure gaps, it is correct that the expenditure ceiling should been seen as supporting the surplus target. But the expenditure ceilings also have their own motivations. They hinder windfall gains to be used as permanent expenditure increases. They also sharpen allocation between expenditures. This is a mechanism that has been noticed in the context of the discussion on quality of public finances at the European Union level. Hence, an advantage of expenditure ceilings is that it could be the case that the expenditures are tilted towards growth-enhancing measures.

On the other hand, the existence of small budgetary margins, the use of tax expenditures and the problem of definition of the economic cycle are, as Boije and Fischer point out, problems worth discussing.[1]

Analytical part of the paper

The analysis on budgetary indicators in the second part of the paper is enlightening. It gives a clear structure to sort out the differences between indicators and it also sorts out the terminology. What do we really mean by fiscal stance, fiscal impulse and fiscal impact?

According to our experiences in Sweden, I believe that measures of structural balances and CABs are problematic to use as measures of compliance with a budget balance target. The uncertainty in the measurement of the level of potential output and the *ex post* revisions of output gaps are two problems. Such indicators should therefore only be used in conjunction with others to evaluate whether current fiscal policies are in line with the overall surplus target. There are also important

[1] The Swedish fiscal framework has also been discussed in Balassone, F. (2005), "Sweden – Selected issues – The Swedish Fiscal Framework: Towards Gradual Erosion?", IMF; Fischer, J. (2005), "Sweden, Country study – Swedish Budget Rules: Praise from Brussels, Pressure at Home", EU Commission; Hansson Brusewitz, U. (2002), "The Swedish Medium-term Budget Framework", in *A Collection of Country Reports*, KDI School of Public Policy and Management, Seoul (Korea); and Hansson Brusewitz, U. and Y. Lindh (2005), "Expenditure Ceilings and Fiscal Policy – Swedish Experiences", in *Public Expenditure*, Banca d'Italia's Workshop on Public Finances.

measurement problems related to one-off measures and some very volatile revenues from taxes, such as capital income taxes and corporate income taxes. It is hard to assess if changes in these revenues are to be considered as permanent or temporary.

Indicators for fiscal stance, fiscal impulse and fiscal impact

Boije and Fischer point out two problem areas that we must carefully consider. The first one comprises the structural changes not related to policy decisions, for instance the demographic and behavioral changes affecting public expenditure. The second one consists of non-indexed benefits which, in practice, are indexed in the medium term.

Personally, I always get uneasy when I see diagrams representing the policy mix of fiscal and monetary policies. It is important to know exactly what is and what is not included in the fiscal stance and monetary stance indicators. Boije and Fischer sort out this aspect nicely and I can only strongly agree with their conclusion that it is particularly important to be aware of the nature of the indicators used.

Impact and impulse

I also fully agree with the authors that changes of net lending could only be seen as an indicator of the impulse from the public sector on the private sector demand and not a measure of the effects of demand. In order to measure the effects on demand, much more sophisticated models would be needed. However, I also believe that it is possible to have at least rough estimates of the effects by analyzing the components of the impulse carefully, *i.e.* how this latter is made up by changes in taxes, transfers, public consumption, net capital income etc.

To use changes in net lending as an indicator of *fiscal impulse* is indeed simple and static. But it is also appealing since this indicator is transparent and gives detailed information on what is going on. The fiscal impulse can be disaggregated into the influences from changes in automatic stabilizers and in structural net lending (fiscal stance). Structural net lending can in turn be disaggregated into discretionary measures by central and local government, net capital income and other effects. The last component can in turn be interpreted as the impact of demographic changes and other structural changes in the economy. We can by this set of indicators show that discretionary fiscal policy by government, fiscal stance and the overall impulse from public sector on demand in the private sector could differ substantially from each other.