INTRODUCTION

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The papers included in this volume provide an overview of recent theoretical and empirical work on four important, closely related fiscal policy issues: fiscal stabilisation, fiscal consolidation, fiscal policy and budgetary institutions, and public expenditure control.

In the context of the European Economic and Monetary Union (EMU), where monetary policy is no longer available at the national level as a macroeconomic tool, attention has increasingly focused on the stabilising role of fiscal policy. Outside EMU, there is a renewed debate on the use of fiscal policy as a counter-cyclical tool. This raises a number of issues. What is the effectiveness of fiscal policy in stabilising the economy? Are automatic stabilisers sufficient? Does discretionary policy cause pro-cyclical behaviour?

In the 1980s and 1990s several countries embarked on major fiscal consolidation efforts. Fiscal positions around the globe showed a marked improvement until the end of the 1990s. In the first part of the new century budget balances deteriorated again in a number of countries, and debt ratios rose in some. These developments brought fiscal consolidation back onto the agenda of policy makers. In this context two issues are prominent. What is the impact of fiscal consolidation on economic activity? Which factors affect the outcome of consolidation efforts?

In recent years the importance of fiscal institutions in achieving and maintaining sound budgetary positions has gained increasing recognition. Many countries have created new institutions and introduced new procedures to reinforce the commitment to fiscal discipline. Many reform proposals have been put forward, including the institution of independent advisory bodies. The main issues are: What rules and institutions best support fiscal discipline? What are the relative roles of European and national rules? What is the possible role of independent bodies?

In many countries the ratio of public expenditure to GDP is at historically high levels. Ageing tends to further increase spending ratios. The capacity of governments to control public expenditure is widely recognised as key to maintaining sound budgetary positions, avoiding pro-cyclical policies, and achieving successful consolidation. National experiences in controlling public spending are extremely diversified. The debate focuses on the role and design of expenditure rules, the role of structural reforms, and policies for the main expenditure areas (pensions, health, welfare and public employment).

The papers presented at the Workshop were divided among four sessions, which correspond to the sections in this volume. Session 1 examines fiscal

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stabilisation, Session 2 fiscal consolidation, Session 3 fiscal policy and budgetary institutions, and Session 4 public expenditure control.

1 Fiscal stabilisation

Section 1 deals with the relationship between cyclical conditions and fiscal policy. The first two papers examine the role of fiscal rules in shaping stabilisation policies. They show that fiscal policy can play a major role in stabilising the economy even in the context of a strict fiscal framework. The third paper assesses the cyclical response of fiscal policies in euro-area countries. It points to the implications of different methodological approaches. The fourth paper examines the factors affecting public debt dynamics in developed countries, pointing to the role of stabilisers and discretionary policies. The last two discuss, respectively, the interaction of fiscal and monetary policy and the role of the uncertainty stemming from macroeconomic forecasts and fiscal projections.

Yngve Lindh and Gösta Ljungman focus on the scope for stabilisation policies in the context of the strict Swedish fiscal framework, characterized by three mutually supportive elements: a surplus target for general government, a multi-annual nominal expenditure ceiling for the central government and a balanced-budget requirement for local governments. The surplus target is set as an average over the business cycle, allowing for countercyclical fiscal policy through both automatic stabilizers and discretionary measures, albeit with the constraint that expansionary policies should be offset during a later phase of the same cycle. The authors propose to use an average of net lending based on both past- and forward-looking data to assess whether the annual target is in line with the surplus target for the cycle. In order to absorb any unexpected increase in expenditure, the government has to set the relevant figures at a level lower than the ceiling. Nevertheless, the margin thus created to mitigate temporary increases could actually be used to expand expenditure permanently. So the authors suggest setting expenditure at a level close to the ceiling. Accordingly, the government has to plan expenditure cuts for future years to make sure that uncertainty can be managed within the ceiling.

Golinelli and Momigliano analyse the cyclical response of fiscal policies in euro-area countries. They review the most recent empirical literature, focusing on a group of studies that use the level of the output gap as an indicator of cyclical conditions and the change in the cyclically-adjusted primary balance to gauge discretionary policies. The authors show that the choices involved in defining a model of fiscal behaviour can be divided into three main groups, according to the dependent variable and the initial conditions of the public finances. They show that these three approaches determine systematic differences in the estimates of the coefficient of the output gap. The results show that changing one’s data source changes the interpretation of the reaction of fiscal policy to cyclical conditions. But the analysis suggests that the supposed pro-cyclical nature of fiscal policies is not borne out by the data. A model enriched with more explanatory variables broadly confirms the conclusions reached on the basis of the basic fiscal reaction function.

Lorenzo Codogno and Francesco Nucci assess the methodology currently used by the European Commission to estimate the deficit-to-GDP ratio that guarantees an adequate safety margin with respect to the 3 per cent deficit ceiling in case of unfavourable cyclical developments (*i.e.* the minimal benchmark). The authors point to several shortcomings. First, in the estimate of the relevant output gap there is *a priori* uncertainty on which data are to be used. Second, the Commission uses short output gap series, which may underestimate cyclical volatility. Finally, a normal distribution for the output gaps is implicitly assumed, and this is not likely to correspond to the data. The alternative methodology proposed by the authors aims at relating the width of the margin to the volatility of the business cycle. The benchmark resulting from the Commission approach and that of the authors does not differ substantially even if, in most cases, the amended methodology calls for a wider safety margin. The authors also provide a complementary analytical tool based on stochastic simulations of a structural macro-econometric model for the Italian economy. The findings are similar to those obtained with the other method.

Mohamed Hassan reviews fiscal policy in Egypt since the early 1980s. He starts with an overview of the main fiscal aggregates, noting that their volatility was dramatically high in the first part of the period and began to decrease in the early 1990s. According to the author, fiscal policy in Egypt is pro-cyclical and mainly based on discretionary measures. Two possible explanations for the pro-cyclicality are provided. One relies on the particular structure of revenue and expenditure, which implies that the main items are out of government control. The second evokes the possibility that changes in fiscal policy actually affect economic growth. The author uses an SVAR model to measure the effect of fiscal policy on both economic activity and monetary policy. He argues that the causal relations between fiscal policy and economic activity is very weak and proceeds from the former to the latter, while that between fiscal policy and monetary policy is strong and also goes from the former to the latter. This suggests that there is fiscal dominance. Under these circumstances monetary policy has no independent role and economic fluctuations are actually exacerbated by fiscal policy.

Harri Hasko aims at assessing the relative impact of unexpected economic shocks and of discretionary monetary and fiscal policy on the debt-to-GDP ratio. His analysis relies on a VAR model that differs from traditional specifications in two main respects. First, he uses output growth, not the output gap. Second, the main public finance variables are expressed as shares of GDP rather than, for example, in logarithmic levels. The study embraces thirteen OECD countries for which annual data are available at least since 1978. The author shows that shocks to inflation and to the debt ratio itself generally played a minor role, while inflation as such played a major role in causing public debt problems. Shocks to monetary and fiscal policy have been the main drivers behind public debt developments since the mid-1970s. They were responsible on average for about half of the forecast error variation in the debt-to-GDP ratio; shocks to GDP growth accounted for almost 30 per cent. Typically, fiscal policy sought to correct the deterioration of the fiscal balance, but often in a number of countries only halting progress was made.

With reference to the Canadian institutional setting, Jenna Robbins, Brian Torgunrud and Chris Matier analyse the uncertainty of both macroeconomic forecasts and fiscal projections. The former are concerned with the dynamics of key variables, the latter mainly with the relationship between output and tax revenues. The authors recall that, from 1994 to 2004, the federal surplus was systematically underestimated. The main reason was the interaction of a stringent no-deficit rule with considerable economic and fiscal uncertainty, which induced forecasters to be conservative. The authors simulate a stochastic model of the economy where the uncertainty surrounding economic and fiscal variables is replicated by introducing random variables. The probability of achieving a surplus is estimated on different sets of assumptions concerning fiscal prudence and historical forecasting errors. The analysis leads to two policy recommendations to reduce uncertainty. The first is to improve forecasting models and methodologies, the second to leave a portion of the planned surplus to guard against negative shocks to the fiscal forecast.

Ranjana Madhusudhan comments on the papers presented by Hasko, by Robbins, Torgunrud and Matier, and by Hassan. On Hasko, Madhusudhan advises adding a sensitivity analysis of the results to the specific model. She also suggests some possible extensions of the paper to explicitly assess the role of both fiscal federal structures and accounting practices. According to Madhusudhan, the second paper could be clearer in providing indications on deficit dynamics in Canada prior to the period studied, and it would also be improved by considering the long-term sustainability of the public finances. As to Hassan, Madhusudhan puts forward a number of suggestions, such as providing a more detailed description of the composition of expenditure and a comparative analysis with other, similar economies.

Jean-Pierre Vidal proposes a general review of the relationship between fiscal policy and economic fluctuations. In theory, it is easy to distinguish between the consequences of automatic fiscal stabilisers and those of discretionary measures or, in other words, between the budgetary impact of the economic cycle and of consolidation measures. In practice, however, it is not so straightforward to assess the fiscal policies that are actually implemented. Different models can lead to somewhat different conclusions and the use of real-time data can produce a systematically biased assessment of output gaps, calling the reliability of estimates into question. The analysis could probably be improved by refining methodology, but this would involve a higher degree of complexity. This highlights the importance of nominal anchors in the system of budgetary surveillance, since they are more transparent and more readily grasped by the public than cyclically-adjusted budgetary figures.

2 Fiscal consolidation

Section 2 deals with issues in fiscal consolidation. The first two papers examine the determinants of successful fiscal consolidations in OECD countries. The third addresses the same issue for the EU countries. The fourth narrows the focus to tax performance in the countries of Eastern Europe and Central Asia. The last three are country studies of Israel, Brazil and Uruguay.

Stéphanie Guichard, Michael Kennedy, Eckhard Wurzel and Christophe André examine the circumstances most commonly related to successful fiscal consolidation. Data are drawn from a dataset covering twenty-four OECD countries since 1978. Based on improvement in the cyclically-adjusted primary balances (CAPB), they detect eighty-five consolidation episodes. First the paper presents descriptive evidence that initial conditions play a major role. In particular, the more negative the CAPB, the larger the ensuing consolidation. In the vast majority of cases, consolidations did not last long and involved only modest gains, and revenue increases accounted for a large fraction of the average improvement. In the second part of the paper, the authors deploy regression analysis to identify a number of macroeconomic conditions that were effective in triggering and sustaining consolidations. The initial budget balance is statistically significant in explaining the starting point, the size and the duration of the adjustment process, while the magnitude and the probability of success of the consolidation programme are affected by cuts in some expenditure items.

Manmohan S. Kumar, Daniel Leigh and Alexander Plekhanov survey industrial countries engaged in fiscal consolidation and assess the macroeconomic consequences. The econometric analysis, based on data covering OECD countries from 1972 to 2006, shows that fiscal adjustments are likely to occur during periods of fiscal troubles and relatively low economic growth. Selected case studies indicate that even if fiscal consolidation reduces economic growth in the short run, it can spur growth in the longer term. In particular, model-based simulations reveal that the short-run restrictive activity are minimised when consolidation relies on consumption tax increases, but maximised when it involves cuts in capital expenditure. In the long run, fiscal consolidation can sustain growth if resources go to decrease capital income taxes and if infrastructure spending is maintained.

António Afonso looks for expansionary fiscal consolidations or, in other words, “non-Keynesian” effects of fiscal policy. The paper focuses on the reaction of private consumption in fifteen European Union countries over the period 1970-2005. The relevant fiscal episodes are detected by three different criteria based on the size and persistence of the variation in the cyclically-adjusted primary budget balance as a percentage of GDP. Two criteria, for the sake of comparison, are modelled on previous works. The third reduces the role of ad-hoc definitions and provides an additional crosscheck of the results. Estimates show that cuts in general government consumption can spur private consumption in the long run. Moreover, the stimulus is stronger when associated with fiscal consolidation. On the other hand, given an increase in government final consumption, consumers may behave in a Ricardian way by presuming a need for future higher taxes. The author calls for specific country studies to better assess the reliability of the theoretical model, noting that the positive expansionary fiscal consolidations in a few countries may not warrant strong policy prescriptions for other countries.

Emilia Skrok and Aristomene Varoudakis analyse the dynamics and determinants of the tax burden relative to its potential value in Eastern Europe and Central Asia over the period 1995-2004. They refer to two indicators: (i) the actual tax-to-GDP ratio as a share of its potential value (the latter being an average of the tax-to-GDP ratio in other similar countries) and (ii) the actual tax-to-GDP ratio as a share of the statutory tax rate. The authors find that, on average, these countries' tax performance is in line with international standards, but this average conceals significant heterogeneity. More specifically, in a number of countries there is margin for increasing revenues by improving both the management of the tax bases and the quality of institutions.

Adi Brender analyses fiscal developments in Israel over the period 1985-2006. He notes that there were two successful episodes of consolidation, in 1985-1992 and in 2003-2006 and assesses their features. The author concludes that the contribution of fiscal rules to fiscal consolidation was negligible, and that setting formal fiscal targets is not an effective precommitment device for future governments. Indeed, credibility requires the present policymakers to choose and implement specific – albeit gradual – measures that keep expenditure under control over the medium term. In Israel effective corrective measures were adopted only after the failure of less comprehensive policy changes and only at times of crisis. Once implemented, these measures seem to survive cabinet changes and economic fluctuations.

Fernando Blanco and Santiago Herrera describe the main fiscal developments in Brazil over the period 1990-2005, with a specific focus on fiscal consolidation efforts in the period 1999-2005. They assess the quality of this adjustment and underline its problematic features: it relied on a sizable revenue increase and on the reduction of public investment, *i.e.* on an unsustainable fiscal strategy. The authors also find that Brazilian fiscal policy was pro-cyclical in the short run. With reference to a longer time span, ranging from the early 1950s to the early 2000s, the paper evaluates the impact of taxation and of the composition of government expenditure on growth. They use both an autoregressive-distributed lag model and a cointegrating VAR. The results point to a significant negative impact on long-run growth of taxation, government consumption and transfers.

Building on a theoretical framework that accounts for the role played by inflation in determining fiscal policy, Gerardo Marcelo Licandro Ferrando and Leonardo Vicente discuss the interaction between fiscal consolidation and price stability in Uruguay from 1970 to 2006. Through the analysis of episodes, correlations and OLS regressions, the authors find that inflation played a major role in improving the fiscal balance via the inflation tax, the real value of debt and the adjustment of real primary expenditure, but the gains were transitory. The paper stresses that despite the important economic reforms of recent years, there are still incentives to use inflation as a fiscal tool, which prevents a sound process of fiscal consolidation.

The comments by Hubert Kempf focus on the studies of Israel, Brazil and Uruguay by Brender, by Blanco and Herrera, and by Ferrando and Vicente. Kempf illustrates the lessons that can be drawn about fiscal policy. First, a broad political consensus and the elimination of fiscal dominance are necessary conditions for successful fiscal consolidation. Second, some fiscal rules can be useful to direct measures towards expenditure cuts rather than revenue increases and towards the reduction of government consumption rather than investment. Finally, doubt is cast on the usefulness of fiscal stabilisation councils.

The comments by Doris Prammer focus on the papers of Guichard, Kennedy, Wurzel and André and of Kumar, Leigh and Plekhanov, both of which identify the key determinants of fiscal consolidations and the properties of success using data for OECD countries, and for a similar time span. The use of different definitions of relevant fiscal episodes is the main reason for the substantial differences in the identification of consolidation periods. The papers share the view that current expenditure cuts are more likely to lead to successful fiscal consolidations than revenue increases, but no consensus on the role of macroeconomic variables emerges. As to the first paper, Prammer advises analysing unsuccessful consolidations as well, in order to better identify the determinants of success. The conclusions of the second paper should call for a more specific and direct focus on the main factors underlying successful consolidations.

The comments by Mikko Spolander focus on the papers by Skrok and Varoudakis and by Afonso. On the former, Spolander suggests that the results in terms of tax efforts and productivity of tax collection could be used to judge whether tax increases or expenditure cuts are the best tool for consolidation. The paper could also be improved by considering, *inter alia*, the role of the inflation tax and the ratio of tax revenue to the corresponding tax base rather than to GDP. As to the second paper, Spolander notes that the results do not support the non-Keynesian view in the short run, and calls for country-specific studies to detect non-fiscal factors affecting economic activity, such as structural reforms, UE accession and external macroeconomic conditions. Finally, he argues that the key issuequestion for policy makers recognizing the necessary conditions for the success of fiscal consolidation is still open.

3 Fiscal policy and budgetary institutions

Section 3 addresses budgetary institutions and their impact on fiscal policy. The first paper focuses on the conditions that can lead the way to better budgetary institutions. The following four investigate various aspects of the mechanisms by which budgetary institutions affect fiscal policy with reference to both fiscal discipline and cyclicality. The last two develop country-specific analysis for Germany and China.

Xavier Debrun and Manmohan S. Kumar deal with the impact of institutions on fiscal discipline, first discussing the point in principle: (i) fiscal institutions can work as commitment devices *(i.e.* tie policymakers' hands); (ii) they can work as signalling devices (*i.e.* reduce the information asymmetry between the electorate and policymakers); and (iii) they can be smokescreens. The second part of the paper develops an empirical analysis to test these three hypotheses, referring to descriptive evidence and estimating a multivariate panel model for a large sample of EU countries over the period 1990-2004. The authors use time-varying indices of fiscal rule restrictiveness and coverage. The analysis finds significant support for both commitment and signalling, little for the smokescreen hypothesis.

Barry Anderson and Joseph J. Minarik discuss issues regarding budget-process rules in the context of the rising fiscal deficits that characterised both the euro area and the United States in the early 2000s. The paper stresses that budget process rules have multiple objectives and so must be judged by multiple criteria, a prominent one being how a set of rules can facilitate (or at least not harm) economic growth while maintaining fiscal soundness and credibility. This is relevant both for the euro-area countries and for the United States, as both have budget-process issues on their policy agenda. The authors evaluate deficit as opposed to expenditure rules according to several criteria, concluding that spending rules seem to perform better.

Building on a recent paper of theirs showing that strong budget institutions can improve outcomes, Stefania Fabrizio and Ashoka Mody study the factors that lead to stronger budget institutions. The paper shows that reforms to strengthen budgetary institutions are less likely to be enacted when deficits are larger, *i.e.* just when they are most needed. This implies that countries tend to gravitate to two types of outcome: either small fiscal deficits and good institutions or large deficits and weak institutions. The authors also find that economic shocks – if they are large enough – can help create a constituency for moving from the latter to the former.

Liu Lida describes the Chinese fiscal framework, reviewing the main features of fiscal policy, its role in controlling macroeconomic variables and its interactions with regulation. In discussing the lessons that can be drawn from the Chinese experience, the paper divides the 1993-2006 period into three subperiods, each with a different fiscal policy stance: after a period of moderately tight policy, the stance turned expansionary in 1998 and neutral in 2005. According to the author, these changes took the outlook for the Chinese economy properly into account and helped promoting growth. In the same vein, Lida discusses the changes in regulation, which shifted from direct to mainly indirect.

Elke Baumann and Christian Kastrop discuss the main features and shortfalls of Germany's current fiscal framework and examine possible reforms. They analyse the shortcomings of the golden rule that has been applied in Germany since the end of the 1960s, which include the rule's asymmetry over business cycles, its unclear specification of the cases under which it can be violated, and the weakness of the enforcement mechanism and the *de facto* absence of sanctions. The paper then discusses possible reforms. The authors stress that a new budget rule should allow for flexibility over the business cycle, be compatible with the Stability and Growth

Pact, be enforceable and be coherent with the decentralised structure of German general government.

Carlos Mulas-Granados, Jorge Onrubia and Javier Salinas-Jiménez investigate the role played by fiscal institutions in the new EU member states that joined in 2004 and in 2007 in the period from 1993 to 2004. They find that budgetary institutions – whose main features are summed up with indices – have had a significant influence on fiscal outcomes. In particular, with respect to the mechanisms whereby institutions affect balances, they show that the executive role (and sometimes also the planning role) of the finance minister has been crucial for pursuing sound public finances. This confirms the importance of institutional arrangements that limit parliamentary changes to the budget.

Joaquim Ayuso-i-Casals, Diana González Hernández, Laurent Moulin and Alessandro Turrini provide a comprehensive overview of the features and effectiveness of numerical fiscal rules set at the national level in the EU since the beginning of the 1990s. The analysis uses synthetic indicators and a new dataset – developed by the authors from questionnaires addressed to country fiscal experts – on the rules in place in the period 1990-2005. The authors investigate the reasons for the increasing number of national fiscal rules and what impact they have had on budgetary outcomes. The analysis shows that the number of fiscal rules has increased continuously and that the introduction of the European rules has played an important role. On the basis of the estimation of augmented fiscal reaction functions, the paper finds that more extensive use of numerical rules tends to reduce the deficit. This relationship is closer the larger the share of general government covered by the rules and the stronger the enforcement mechanism. The analysis also supports the view that the design of fiscal rules may affect the cyclical behaviour of fiscal policy.

Ernesto Rezk analyses the determinants of subnational public spending in Argentina. After a brief survey of the recent literature and a description of the main stylized facts on provincial expenditure in Argentina, the paper provides an empirical analysis which covers the twenty-three Argentinian provinces and the autonomous city of Buenos Aires over the period from 1993 to 2004. The econometric analysis aims at assessing the provinces' public expenditure trends by considering both the role of economic and fiscal variables and that of political and institutional factor. The paper underlines that, while the role played by fiscal variables – such as transfers, public debt and revenue as a share of expenditure – is important, results for other factors are less conclusive.

The comments by Marco Buti concern the papers by Fabrizio and Mody, by Debrun and Kumar, and by Anderson and Minarik. The first paper – which empirically investigates the conditions under which fiscal rules are introduced and/or budget institutions improved – is based on a sound econometric analysis, but Buti offers several suggestions for developing it further: adding both a Maastricht and a Stability and Growth Pact dummy, accounting for fiscal constraints on lower levels of government, taking account of time inconsistency and soft institutions (e.g. internal pacts, coalition agreements). As to the second paper, the commentator notes that its wide range of issues makes it difficult to grasp the links between the theoretical model, the empirical findings and the policy implications; the robustness of the empirical analysis could also stand improvement. With reference to the third paper, Buti agrees with the authors that expenditure rules can contribute to sound fiscal policy, but stresses that they cannot and should not replace the current EU fiscal rules. He also argues for a more balanced view of the past performance of fiscal policy under the Stability and Growth Pact.

David Heald comments on the two country-specific papers. With reference to Germany, he stresses that in addition to the issues that the authors address, one should also consider measurement problems, the existence of margins for discretion and so potentially for window dressing, and the possibility of replacing direct public intervention in the economy with regulation. For China, Heald says that assessing the Chinese fiscal framework using the traditional tools may turn out to be misleading, because China has not yet completed its transition to the market economy. Indeed, more information concerning the basics of the economic situation and, in particular, of the fiscal framework and outlook would be of the greatest interest.

The comments by Álvaro Manuel Pina focus on the papers by Mulas-Granados, Onrubia and Salinas-Jiménez and by Ayuso-i-Casals, González Hernández, Moulin and Turrini. On the former paper, with reference to the indices that characterise budget institutions, he sees the need for systematic comparison bearing on institutional characteristics, the interpretation of the actual national arrangements, and weighting mechanisms. Moreover, he calls for prudence in interpreting the estimates of fiscal reaction functions and suggests further development of the sensitivity analysis. With reference to the second paper, he focuses on issues of robustness. He questions the robustness of the analysis to determine which characteristics of the rule matter the most for fiscal discipline and also suggests checking the robustness of the results on the impact of numerical rules on fiscal policy cyclicality with respect to different measures of cyclicality.

4 Public expenditure control

Section 4 deals with the control of public expenditure. The first paper examines the role of the public expenditure policies in debt reduction strategies. The second focuses on the effectiveness of expenditure rules, the third on the relationship between public expenditure and economic growth in Europe, and the fourth on the role of public expenditure in making fiscal policy asymmetric over the cycle. The last two papers examine the experiences of the Netherlands and Japan.

Carine Bouthevillain, Laurent Paul and Jeanne Pavot observe that government debt in major developed countries has reached historically high levels for peacetime. They argue that in many countries, especially in Europe, fiscal adjustment must come from the control of public spending. The first part of the paper examines several countries that have successfully reduced deficits and points to some general features of their experiences. The second part considers public expenditure developments in EU countries and evaluates the role of spending.

During the 1990s a number of EU countries introduced national expenditure rules as a central institutional arrangement in budgetary management. Peter Wierts assesses the effects of these self-imposed rules on fiscal behaviour. His model highlights the common pool problem and the political and institutional costs of non-compliance, using a database on national expenditure rules, fiscal plans and outcomes, and macroeconomic variables. Wierts shows that countries with higher initial expenditure (in proportion to GDP) have introduced stricter expenditure rules, which curbed spending as expected and mitigated the effect of shocks on public expenditure. There are some indications that the countries with stricter expenditure rules may at times have increased tax expenditures in order to circumvent them.

Alfonso Arpaia and Alessandro Turrini analyse the relationship between government expenditure and potential output in European Union countries. They consider a sample comprising fifteen countries from 1970 to 2003. Panel cointegration tests show that the two variables are linked by a stable long-run relationship. The elasticity of expenditure with respect to GDP is slightly less than 1. Estimates are fairly robust over time and across countries. There is evidence of a significantly higher elasticity in countries characterised by low initial per capita GDP, relatively fast population ageing, low public debt ratios and weak numerical rules for the control of expenditure. The average time of adjustment of public expenditure to its long-term relationship with potential output is about three years, but there are significant differences across countries, with the Anglo-Saxon and Nordic countries adjusting more rapidly. Finally, the authors examine the implications of these findings for the EU fiscal framework.

Fabrizio Balassone, Maura Francese and Stefania Zotteri present a stylised framework of fiscal policy determination that considers both structural targets and cyclical factors. They find significant cyclical asymmetry in the behaviour of fiscal variables in a sample of fourteen EU countries in the period 1970-2004: budgetary balances deteriorate in contractions and do not improve correspondingly in expansions; discretionary policy appears to partly offset automatic stabilisers. Cyclical asymmetry comes from expenditure, in monetary transfers. The authors gauge the impact of European fiscal rules and find no evidence that they have modified the asymmetry of policy. Numerical simulations show that cyclical asymmetry increased deficits and contributed to the accumulation of the debt. The authors note that these results tell in favour of expenditure rules. Committing to a predetermined rate of growth of expenditure can curb the tendency to increase public spending in cyclical expansions, while leaving the automatic stabilizers on the revenue side free to operate. It is also important to ensure that the pro-cyclical bias not be transferred to the revenue side of the budget and that there be a long-term anchor to fiscal policy.

Frits Bos examines the fiscal policy framework of the Netherlands and the role of the Central Planning Bureau (CPB). The main features are expenditure ceilings, a focus on long-term sustainability and the role of independent organisations. Multi-annual expenditure ceilings are determined at the start of each new term of government. They are intended to be realistic estimates of the expected expenditure in real terms. Bos discusses the problematic features of these ceilings. As to sustainability, Bos examines the role of the Economic Structure Improvement Fund and the role of fiscal indicators, such as generational accounts and the "robust balance" introduced by the CPB. Finally, he highlights the role of the CPB in the decision-making process. It evaluates election platforms, provides short-term, medium-term and long-term estimates of the Dutch economy and public finance, and has input on decisions concerning structural reforms and major infrastructure projects.

Kajikawa examines the role of public expenditure control in Japanese fiscal consolidation. After outlining recent fiscal developments, he discusses the control of two types of expenditure: project and programme. The former comprises investment and current spending for the implementation of specific projects, the latter social protection and health care. Capping can be effective for project spending, since a limit to disbursement can be set in the budget process. The dynamics of programme-type expenditures can only be modified by changing the design of the programmes themselves.

John Janssen comments on the papers by Bouthevillain, Paul and Pavot and by Wierts. While agreeing with their main indications, he suggests some possible ways of improving the analysis. On the first paper, he proposes considering the role of structural reforms that affect unemployment and paying greater attention to the literature on expansionary fiscal contractions. On the second, he advises considering additional factors, such as the relative strength and past experience of coalition partners. Janssen observes that an expenditure rule does not obviate the need for a fiscal balance target or for dealing with revenue windfalls and forecasting errors. And, in the context of population ageing, long-term expenditure rules may need to be specified so as to allow for changes in spending that result under tax-smoothing/pre-funding fiscal strategies.

Bernhard Manzke comments on the paper of Balassone, Francese and Zotteri and that of Arpaia and Turrini. Concerning the first paper, he stresses that asymmetry in fiscal policy may be due to discretionary policies that offset automatic stabilisers in good times by increasing monetary transfers; lax fiscal policies in good times, it is argued, are at the root of fiscal problems in the subsequent downturn. As to the second paper, Manzke is puzzled by the fact that the long-run elasticity is slightly below 1 for the whole period, but not for the individual sub-periods. He also offers alternative explanations of short-run elasticity, which may reflect real-time misperceptions of potential GDP or the role of discretionary fiscal policy. He also notes that the high variability of the long-term elasticity over time and the high dispersion of the short-term national elasticities make caution indispensable in drawing policy lessons at the EU level.

Margit Schratzenstaller discusses the papers of Kajikawa and of Bos. She argues that the experiences of Japan and the Netherlands are of particular interest for other countries, such as Austria, that are considering the institution of some kind of fiscal framework to improve the management of public spending. She emphasises that Kajikawa draws attention to the fact that different types of expenditures call for differentiated control strategies. She also raises two issues: how expenditure control can be guaranteed for all levels of government; and how the Japanese control rule can work without being binding. Schratzenstaller praises Bos's insightful analysis of Dutch fiscal policy, but observes that the fiscal framework is very much grounded in the Dutch political context and that it cannot be simply transposed to other countries with different institutions. She also wonders whether such a framework can be applied in a federal country.