COMMENTS ON SESSION IV
PUBLIC EXPENDITURE CONTROL

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Introduction

Let me start by thanking Daniele and his team for the invitation to this workshop, their organisation and hospitality. I would also like to thank Daniele for the opportunity to comment on two interesting papers in this session. My comments on the papers are from the perspective of a fiscal policy practitioner. I conclude with some general comments and observations on fiscal consolidations and the role of expenditure rules.

1 Comments on "Debt Retrenchment Strategies and Control of Public Spending" by Carine Bouthevillain, Laurent Paul and Jeanne Pavot

This paper provides a useful survey of the considerations behind the selection of a debt target. I agree strongly with the need to consider a broad range of factors and the importance of country specifics. These factors can include the nature of economic shocks, future demographic changes, the cost of debt servicing in relation to other government spending, and the structure of the government balance sheet. Importantly, these factors can alter over time as the structure of the economy changes (say in response to structural reform) and as new information comes to hand.

Nonetheless, the use of a "different or variable sustainable debt level" in the face of demographic change may be problematic. If population ageing is the result of long-lasting declines in birth rates and increases in life expectancy, then the gap between primary revenues and primary expenditures is likely to persist. Changes to spending and/or taxes will be needed at some point. This is a key result of the long-term fiscal projection exercises carried out in various countries including the United States, Australia and New Zealand.

The paper correctly concludes that tackling the primary fiscal balance is crucial and considers four case studies (*i.e.*, Canada, Spain, Sweden and Finland). I would reinforce the importance of "other structural reforms" and in particular, the positive fiscal dynamics created by lower structural unemployment and reduced unemployment spending. As a result, the section on "Patterns in public spending in Europe since 1972" would benefit from a closer examination of spending on

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unemployment. At a detailed level, I am interested in whether the Canadian audit to pinpoint efficiency gains and unwarranted expenditure was just a one off – and if so, why?

For a paper that is essentially about fiscal consolidation I would have expected more attention on the literature relating to so-called expansionary fiscal contractions.

Finally, the paper suggests that an expenditure rule scores favorably. This is in line with the discussion at the earlier sessions of the workshop and in particular, the conclusions in the paper presented by Anderson and Minarik.

2 Comments on "How Do Expenditure Rules Affect Fiscal Behaviour?" by Peter Wierts

This paper sets up a model that captures a range of institutional factors and the consequences of non-compliance to an expenditure rule so that: expenditure is increasing in target expenditure, the number of spending ministers, and decreasing in the strength of enforcement. The empirical implications of the model are tested with special consideration given to causality between rules and outcomes.

In terms of the model set up, one can think of potential enhancements such as including the relative strength of coalition partners and with more difficulty, the past experience of coalition partners. In the latter case, political fragmentation might be a function of the degree of experience each coalition partner has.

The role of more spending ministers in creating a spending bias is an interesting one. Absent a reduction in the number of ministers, one potential way to mitigate the bias might be to impose mechanisms that create closer budgetary examination of the "big spenders" and streamline the others. Another approach might be to group the various spending ministers into "themes" that allows closer examination while also assisting with cross-agency coordination and delivery of outcomes.

I agree with the importance of dealing with tax expenditures, as highlighted in the case study of the Netherlands. Amendments to the Public Finance Act in New Zealand have added annual reporting on tax policy changes. The Netherlands case study also raises important questions of how to deal with revenue windfalls – Kok-1 had a discretionary approach while Kok-2 had a fixed formula.

3 General comments

In terms of the debt retrenchment issues raised in the first paper, one is left wondering whether the "stars will ever align at the same time?" Fiscal consolidation seems to be motivated by a mix of sustainability concerns, financial market pressures, macroeconomic conditions, and a determined Finance Minister. A lesson from the Brander paper on fiscal targets and consolidation in Israel is that it pays to be specific.

I take the view that fiscal rules and more comprehensive fiscal reporting can help to lock-in a fiscal consolidation, but other motivating factors are likely to play a role (e.g., the fiscal implications of population ageing, the deadweight cost of taxes, the benefits of tax smoothing).

Several commentators at this workshop have advocated a stronger role for expenditure rules to address the spending bias at its source and to enhance accountability. While an expenditure rule can provide an important complement, it is not clear that it removes the need to consider the target for the fiscal balance or how to deal with revenue windfalls and forecasting errors. Recent experience in New Zealand suggests that persistent revenue surprises will require a reconsideration of multi-year expenditure plans at some stage. Furthermore, 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.