COMMENTS ON SESSION 4
PUBLIC EXPENDITURE CONTROL

Margit Schratzenstaller[*]

1 Discussion of "Fiscal Consolidation Strategy in Japan: The Role of Expenditure Control: The Role of Expenditure Control" by Mikio Kajikawa and "The Dutch Fiscal Framework and the Role of the Central Planning Bureau" by Frits Bos

Both papers to be discussed in what follows are dealing with the question how to control and to manage public expenditures so as to contribute to the long-term sustainability of public finances. Thus, the two papers address a policy issue that particularly during the past decade has emerged as one of the greatest challenges for policy-makers: particularly in face, firstly, of the future demographic pressures projected for all industrialised countries and creating pressures especially in the realm of social expenditures; and, secondly, of the high debt burdens and the correspondingly considerable interest liabilities many countries have. Not to let spending in these areas get out of control is one of the most essential preconditions for the improvement of the quality of public finances in general and of the quality of public spending in particular. Improving the quality of public expenditures is one of the guiding principles agreed upon, for example, by the European countries as part of the European Union's so-called Lisbon strategy to foster growth and employment, formulated in 2000.[1] Hereby the focus is on the restructuring of expenditures towards more spending in future-related areas, particularly education, research and development, and infrastructure, to help the EU make the most productive and competitive economic region in the world. The role of budgetary institutions in the reallocation of public funds towards more "productive" spending purposes is attracting growing attention within policy debates on the national, but also on the supranational level. In this vein the OECD, for example, recently published a report (OECD, 2005) pointing out the importance of medium-term expenditure frameworks, rules of budgetary discipline, the role of the minister of finance, and programme review. There is also considerable empirical evidence that improving the institutional quality of budget processes is tantamount to an improvement of fiscal performance (for a selection of empirical studies, see von Hagen, 2006).

The reports from Japan and the Netherlands how these two countries are trying to control public expenditures illustrate many of the aspects that have been discussed from a theoretical point of view in the course of this workshop by adding practical experience. Thus, they are of particular interest for countries considering the implementation of some kind of fiscal framework to improve the management of public spending, for example Austria.

[*] WIFO – Austrian Institute of Economic Research, Austria.

[1] See, e.g., A. Sapir (ed.) (2003).

This comment and the discussant's specific interest in the two papers are specifically motivated by the fact that the questions brought up in both papers are very topical in Austria currently. Here, more than two years ago an agreement was reached between all political parties represented in the Austrian National Parliament[2] to introduce a reform of the budgetary framework in the year 2007. The conclusion of this agreement was followed by the preparation of a detailed draft law. Basically, the envisaged new budgetary framework should consist of two main elements, which are to be implemented in two steps. Firstly, a medium-term fiscal framework with (in principle) fixed expenditure ceilings, which originally should be introduced in 2007. Secondly, performance-based budgeting, *i.e.* complementing the traditional input orientation of the budgeting process by also taking into account outputs and outcomes of budgetary measures, originally to be implemented in 2011. Both elements remind strongly of the Dutch fiscal framework, which in fact served as an influential example for the intended Austrian reform. However, the coalition government which was in office till autumn 2006 (consisting of the People's Party and the Freedom Party) and the Social Democrats as the largest opposition party were not able to agree on which parliamentary committee should deal with the draft law. Therefore it was not passed during the term of the last federal government. The new Grand Coalition between the Social Democrats and the People's Party governing since January 2007 has declared the reform of the budgetary framework one of their core reform projects (together with other reforms within the public sector, particularly a state reform and an administrative reform). Therefore the new federal government currently aims at implementing the budgetary reform by the years 2009 and 2013, respectively: provided that the coalition partners are able to solve several points of disagreement due to which the draft law is still pending.[3]

Before having a closer look at the two papers which are to be discussed in this comment, some of the most important arguments in favour of the introduction of spending rules are to be summarised (see, e.g., Angelo *et al.*, 2004).

Firstly, regarding the adequate fiscal policy for a given economic situation, spending rules are considered relatively flexible, particularly compared with a balanced budget rule. They do not prevent automatic stabilisers on the revenue side from working. Moreover, expenditure ceilings can be allowed to vary with the business cycle for cyclically-sensitive spending categories. Secondly, spending rules

---

2 Which are the People's Party, the Social Democrats, the Greens and the Freedom Party. Such an all-party-agreement was necessary because part of the reform would affect the Austrian Constitution and therefore require a two-third majority in the National Parliament, which the coalition then in office (the People's Party and the Freedom Party) would not have disposed of.

3 Currently there seem to be two major points of disagreement. The first one is the recommendation given in the new law that the new budgetary framework, which would only encompass the federal level, can also be applied by the states (*i.e.* the Bundeslaender), which meets with fierce resistance from the side of the states, which insist on their budgetary autonomy. The second one is the role of the Federal Minister of Finance who would be awarded more competencies *vis-à-vis* the other ministers within the new budgeting framework. Thus, by the way, the Austrian case can also serve as an example with respect to the question when and how new fiscal rules can be introduced at all; and particularly such rules which limit the discretionary power of politicians: basically it obviously all boils down to the question whether one really can expect that politicians are willing to tie their hands voluntarily.

support the pursuit of an anti-cyclical fiscal policy, by hindering politicians to use additional revenue in good times for the introduction of new spending programmes (and thus to act procyclically), and by forcing them instead to use such windfall gains for the reduction of public debt. Thirdly, spending rules make the whole budgeting process more rational, by limiting the influence of special interest groups, by requiring medium- and long-term planning of expenditures and spending programmes, etc. Fourthly, the medium- and long-term perspective enforced by spending rules supports the pursuit of longer-term spending priorities. And finally, spending rules increase political accountability, as violations of a spending rule are more transparent and can be traced back better than violations of, for example, a balanced budget rule.

2 "Fiscal Consolidation Strategy in Japan: The Role of Expenditure Control" by Mikio Kajikawa

The paper by Miko Kajikawa (Japanese Ministry of Finance) is about the medium-term path towards fiscal consolidation in Japan. The Japanese government aims at achieving a primary balance surplus for the general government by the year 2011.[4] During the ensuing five years, the debt-to-GDP-ratio, currently lying at about 150 percent, is to be reduced. To realise its target of a primary balance surplus, the government plans considerable expenditure cuts and therefore needs to control public spending very stringently. Hereby, the general long-term socio-economic background and development trends Japanese fiscal policy has to take into account equal those prevailing also in most other advanced economies. Japan, too, is confronted with an ageing population, so that social spending has expanded already in the past and can be expected to grow further. To curb total expenditures, government investment has been restricted in past years. Therefore, public finances in Japan seem not only to face the problem of decreasing sustainability. Rather, the structural shift in overall spending away from public investment towards social expenditures also seems to indicate a long-term deterioration of the quality of state expenditures: in the sense that spending categories that are comparatively less benefical for economic growth are gaining in importance at the expense of such public expenditures exerting a comparatively larger positive impact on economic growth.[5]

The paper focuses on an aspect often neglected in the theoretical, empirical and policy-oriented work on spending rules: namely, which concrete strategy should be pursued to control public expenditures, for example, to bring or to keep them below a fixed upper limit. Kajikawa draws attention to the important fact that there

---

4 The current initiative to restrict public expenditures is the last one in a number of more or less rule-based efforts to contain and to restructure, respectively, public spending in Japan; for an overview and critique of the diverse fiscal rules in Japan see von Hagen (2006).

5 See Schratzenstaller (2007) for an overview of numerous empirical studies on the growth effects of different spending categories.

is no "one size fits all"-approach to control public spending. Rather, different types of expenditures call for differentiated control strategies. This insight is crucial insofar as the neglicence of this point may be one explanation for the ineffectiveness of efforts to control public expenditures many governments experience in practice.

The author distinguishes between two ideal spending categories: project-type expenditures on the one hand and programme-type expenditures on the other hand. Project-type expenditures are expenditures connected with a specified single project, e.g. the construction of a highway. Programme-type expenditures are related to complex political programmes pursuing specific goals, for example providing a certain level of health care services.

The rules Kajikawa states with respect to these two expenditure categories are as plausible as they are simple at the same time. Project-type expenditures, on the one hand, can be restricted directly in the budgeting process, by making the decision to just cap them, *i.e.* to implement a certain project at a smaller scale or to not realise it at all. Restricting programme-type expenditures, on the other hand, cannot be achieved in the budgeting process itself, but requires politicians to engage in programme design – *i.e.* to effect structural reforms, for example directed at the health care or the pension system.

The paper raises, however, two important questions.

Firstly, particularly from the perspective of a federal country (like Austria), which typically consists of three layers of government (the federal level; the regional level, e.g. states; and the municipalities), the coordination of expenditures and expenditure control between the central and the subnational governmental levels is of crucial importance. Japan's fiscal target – a primary balance surplus by 2011 – refers to the general government, *i.e.* the central and the local level combined. This brings up particularly the following questions, which would have to be clarified not only in a federal country, but probably also in a unitary state: Who decides on the fiscal target for the existing governmental levels together? To what extent are the individual levels of state to contribute to the overall fiscal target? And are there any sanctions imposed if one of the governmental levels does not fulfil its obligations?

The second question refers to the fact that the roadmap devised by the Japanese government to achieve a primary balance surplus by the year 2011 is not legally binding. In my opinion, however, the successful implementation of the rules established for controlling project-type as well as programme-type expenditures requires absolutely unselfish and benevolent politicians who are neither concerned about the next elections nor about their own prestige and power. It is, however, doubtful whether politicians are solely concerned about the short- and long-term general welfare. Certainly the so-called Leviathan hypothesis according to which politicans and bureaucrats do not care about the welfare of their citizens at all, but only pursue their own interests and goals – which only partially or not at all coincide with the general interest – is exaggerated. However, it appears questionable whether politicians are really willing to completely and voluntarily forego, for example, bork barrel projects dedicated to their regional constituency the benefits of which are smaller than the costs so that they would present themselves as natural candidates for expenditure cuts. Thus, it also seems doubtful whether the Japanese expenditure control rules really can work effectively without being complemented with binding fiscal rules. And to me it remains an open question how deviations from the roadmap towards a primary balance surplus will be enforced.

3 "The Dutch Fiscal Framework and the Role of the Central Planning Bureau" by Frits Bos

The paper by Frits Bos (Central Planning Bureau, CPB) elaborates on the Dutch experience with the introduction of a new fiscal framework; and this, most interestingly, from an insider perspective, as the CPB is one of the actors directly involved in the reformed budgeting process. This account is a rich source for all sorts of economists. First of all for those who are interested in the concrete and operational aspects of the fiscal framework that was introduced in the Netherlands in the beginning of the nineties and often serves as a very positive example for the successful and effective design of fiscal rules: not only within Europe, but also in the – critical – eyes of the International Monetary Funds, for example. Moreover, the paper is also of interest for thos who like to put the development of public finances and of fiscal policy in a long-term perspective: the paper definitely does view Dutch public finances in a long-term, one might even say in a historical perspective. And finally, it is not the least merit of this report to show how large the challenge to achieve sustainable and stable public finances over a long period of time really is and how quickly things can change: how fast, for example, a situation of sound public finances can deteriorate or even reverse completely.

Of particular interest to the discussant – for the reasons already mentioned above – is the part of the paper that is dealing in great detail with the reformed Dutch fiscal framework, potential practical problems, and needs for adaption. The following aspects and questions appear to be especially relevant:

- Firstly, the question of "cheating", *i.e.* of undermining the expenditure ceilings, by substituting direct expenditures by tax expenditures, of by substituting direct expenditures by cheap loans of by state guarantees: whether and how such evasion measures are taken into account when actual spending is monitored and when it is evaluated whether the existing expenditure limits were properly respected appears crucial to guarantee the effectiveness of expenditure ceilings.
- Secondly, the target that is aimed at by limiting public spending needs to be specified. The envisaged goal could lie in a wide range: from "only" complying to the debt targets (and, in the medium-term, the surplus targets, respectively) of the European Stability and Growth Pact to limiting or even reducing the size of the public sector in the long run.
- A third question is which role the structure of public expenditures, besides their sheer level, play, *i.e.* again the whole issue of the quality of public spending. This question appears to be linked to performance-based budgeting (the second

principal element of the Dutch fiscal framework): in this regard it certainly is useful to establish an explicit link between performance-based budgeting on the one hand and the medium-term fiscal framework with its expenditure ceilings on the other hand.

- Fourthly, the presentation of the Dutch fiscal framework brings up the question whether cyclically-sensitive expenditures should really be included in the expenditure framework. As already mentioned, the medium-term budgetary framework the Austrian government intends to implement would exclude certain cyclically-sensitive spending categories, such as unemployment benefits. As also argued above, this seems to make sense: the inclusion of expenditure items that are dependent on cyclical fluctuations would not allow automatic stabilisers on the expenditure side to come into force and would thus severely restrict the stabilisation function of the public budget in a way that might exacerbate cyclical fluctuations. Of course there is a trade-off between flexibility on the one hand and comprehensiveness (and therefore effectiveness) of the spending rule on the other hand which has to be taken account of when defining those spending categories that are to be assigned no fixed upper ceiling.

4 Conclusions

The comment will conclude with some general remarks.

- Firstly, the paper mentions the “Dutch tradition of consultation and coalition governments” when talking about the specific role of the CPB as one central actor in putting the Dutch fiscal framework into operation. This underlines – in the discussant's opinion absolutely correctly – the necessity to take into account the existing country-specific institutions, norms and traditions when a government tries to successfully implement and manage a certain fiscal framework: and it draws attention to the fact that there are specific institutional conditions for introducing and successfully applying a fiscal framework as it exists in the Netherlands, or to put it in other words: the Dutch fiscal framework – even though often referred to as a success story – for sure cannot be imposed onto other countries more or less unchanged. Rather such a transfer would have to consider the existing country-specific institutions and norms and would have to take care that the budgetary framework is adapted accordingly.
- Secondly, and related, there is the question whether such a fiscal framework could be also applied in a federal state, or if one of the general conditions for a successful implementation is a rather centralised state? Or, to phrase it differently: the question whether, to what extent and how the successful operation of such a fiscal framework as implemented in the Netherlands requires coordination between the individual layers of governments.

REFERENCES

Angelo, S., M. Marterbauer, I. Mozart, B. Rossmann, M. Schratzenstaller and N. Temple (2004), "Alternatives to the Stability and Growth Pact – Proposals for a New EU Fiscal Policy Regime", Vienna, Federal Chamber of Labour.

Sapir, A. (ed.) (2003), *An Agenda for a Growing Europe*, Oxford, Oxford University Press.

OECD (2005), *Reallocation: The Role of Budget Institutions*, Paris, OECD.

Schratzenstaller, M. (2007), "Wachstumsimpulse durch die öffentliche Hand", *WIFO Monatsberichte*, Vol. 80, No. 6, pp. 509-26.

von Hagen, J. (2006), "Fiscal Rules and Fiscal Performance in the European Union and Japan", *Monetary and Economic Studies*, Vol. 24, No. 1, pp. 25-60.