

## COURSE SYLLABUS

# FISCAL POLICY IN PRACTICE

**Instructor:** Balázs Romhányi

Name, title: visiting

Department: Economics

Central European University

Semester/term, year Winter, 2016/17

Course level (MA, PhD) MA

# Credits (# ECTS Credits): 4

Pre-requisites (if applicable): Intermediate level in microeconomics and macroeconomics

Course e-learning site:

Office hours: days, location

### Course Description

Presentation of the major issues in fiscal policy and public financial management: theoretical foundations, empirical measurement, institutional solutions

### Learning Outcomes

The primary goal of the course is to link economic theory to the basic notions, problems and solutions of fiscal policy and budgeting in practice. A secondary goal is to help students analytically think about the budgeting system of their home country, and to learn how international good practice handles the problems they face.

### Course Requirements

1. Essay comparing the budgeting system of three countries
  - length: max 10 pages
  - deadline: March 27, 2017
  - weight: 40%
  - by every day of late submission the maximum attainable score is reduced by 4% points (that is the same paper if submitted on time might get 30, if submitted 5 days later gets only 15 or 0 after 10 days)
2. Written exam for grade with weight: 50%. Covering important notions and phenomena, short problems and essay type questions (to get a more specific idea, look at "Illustrative exam questions.pdf" at the e-learning webpage of the course).
3. Activity 10% (measured by short random tests during the lectures)
4. Optional 40 minutes presentation of one optional reading or participation in an organized debate with 20% weight (this means that the theoretically

maximum score is 120%, that is, those who undertake a presentation or participation in the debate “gain” 20 points)

In order to get the minimum pass grade (C+) for the course, at least 50% of the weighted marks must be obtained

Requirement for an “Audit”: Minimum 6%points in activity

## **COURSE SCHEDULE**

Part I. and Part II. will certainly be covered. Depending on the time remaining and the interest of the students some of the optional topics (Part III.) will also be dealt with. Exam will consist only of the topics covered.

Not each of the topics will take exactly one lecture, some might be shorter, some others longer.

### **Part I. The macroeconomic role of fiscal policy**

#### **Topic I.1. Macroeconomic effects of fiscal policy**

*Content:*

fiscal sustainability; fiscal multipliers; automatic and discretionary stabilization; empirical facts; interactions between monetary and fiscal policy

*Required Reading:*

- (1) John F. Cogan & Tobias Cwik & John Taylor & Volker Wieland, "New Keynesian Versus Old Keynesian Government Spending Multipliers," *Journal of Economic Dynamics and Control*; Volume 34, Issue 3, March 2010, Pages 281–295.

*Recommended Reading:*

- (1) Olivier Jean Blanchard, 1990. "Suggestions for a New Set of Fiscal Indicators," OECD Economics Department Working Papers 79, OECD Publishing.
- (2) Fabrizio Balassone & Daniele Franco, 2000. „Assessing fiscal sustainability: a review of methods with a view to EMU,' in *Fiscal Sustainability*, Banca d'Italia, Rome
- (3) Vladimír Bezdek & Kamil Dybczak & Aleš Krejdl, 2003. „Cyclically Adjusted Fiscal Balance – OECD and ESCB Methods," *Czech Journal of Economics and Finance*, 53, 2003, pages 477-508

#### **Topic I.2. The economic role of the government**

*Content:*

The 3 Musgravian roles of the government; The principles of taxation; main kinds of taxes; the Laffer-curve; Deadweight loss and tax incidence; Consumption taxation; Income taxation; Tax administration; optimum taxation; the main expenditure programs

*Required Reading:*

*Recommended Reading:*

- (1) Emmanuel Saez & Joel B. Slemrod & Seth H. Giertz, 2009. "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review," NBER Working Papers 15012, National Bureau of Economic Research, Chapters 1-2
- (2) Bernard Salanié: The Economics of taxation, 2011, MIT Press

**Topic I.3 The System of National Accounts**

*Content:*

The System of National Accounts (SNA); government in different statistical systems; link of the budget balance and other financial statements of the economy; different concepts of the budget balance; cyclical adjustment; one offs;

*Required Reading:*

*Recommended Reading:*

- (1) François Lequiller & Derek Blades, 2006, „Understanding National Accounts,” OECD, Chapter 9: The General Government Account

**Topic I.4. Fiscal data**

*Content:*

primary data sources (transactions in the treasury, institutions' reports); accounting, statistics and budgeting (institutional delimitations, cash flow vs accrual accounting.); functional and economic classification of budget items; mandatory and discretionary items; gross and net expenditures; some budget gimmicks

*Required Reading:*

- (1) MGE Chapters 3 and 10
- (2) Allen Schick, 2007. „The Federal Budget: Politics, Policy, Process,” 3rd edition, Brookings Institution Press, Washington D.C. (ISBN: 978-0-8157-7735-9), Chapter 3: The Budget's shifting boundaries

*Recommended Reading:*

- (1) John H. Engstrom, 1998. „Understanding and Using Government Financial Statements,” in: Meyers, Roy T.(ed.) “Handbook of Government Budgeting,” (*hereafter HGB*) Chapter 5, pages 119-156, Jossey-Bass Publishers, San Francisco
- (2) James L. Chan, 1998. „The Basis of Accounting for Budgeting and Financial Reporting” in: HGB Chapter 14, pages 357-380

**Topic I.5. Forecasting in fiscal policy**

*Content:*

the main budget items; elementary forecasting methods; conditional and unconditional fiscal forecasts; medium and long term base line scenarios, generational accounting

*Required Reading:*

*Recommended Reading:*

- (1) Congressional Budget Office, 2015 “An update to the budget and economic outlook: 2015 to 2025”
- (2) Congressional Budget Office, 2015 “The Long Term Budget Outlook”
- (3) Congressional Budget Office, 2015 “An Analysis of the President’s 2016 Budget”
- (4) Jagadeh Gokhale on Generational Accounting, 2007, Cato Institute  
[http://www.cato.org/pubs/articles/gokhale-generational\\_accounting.pdf](http://www.cato.org/pubs/articles/gokhale-generational_accounting.pdf)

**Topic I.6. Fiscal impact assessment**

*Content:*

macromodelling of fiscal policy; Ricardian equivalence; microsimulation; direct and indirect effects; behavioral effects; macroeconomic effects; quality of public finances

*Required Reading:*

*Recommended Reading:*

- (1) Assessment of the Fiscal Council of the Republic of Hungary of the Fiscal Impacts of Bill No.T\_1376
- (2) Roberto Ricciuti, 2003. "Assessing Ricardian Equivalence," Journal of Economic Surveys, Wiley Blackwell, vol. 17(1), pages 55-78, February.
- (3) Congressional Budget Office, 2010. “Selected CBO Publications Related to Health Care Legislation, 2009–2010,”

**Part II. Public financial management**

**Topic II.1. Budgetary decision-making**

*Content:*

time inconsistency; common pool problems; deficit bias; pro-cyclical fiscal policy, political budget cycles, the optimum size of government, mechanism design

*Required Reading:*

- (1) Dirk-Jan Kraan, 1996. "Budgetary Decisions", Cambridge University Press, Chapter 2.: The structure of the budgetary process

*Recommended Reading:*

- (1) Ernesto Talvi & Carlos A. Vegh, 2005. "Tax Base Variability and Procyclical Fiscal Policy," Journal of Development Economics vol.78, pp.156-190

- (2) Lane, Philip R., 2003. "The cyclical behaviour of fiscal policy: evidence from the OECD," *Journal of Public Economics*, vol. 87(12), pages 2661-2675, December.
- (3) Alberto Alesina & Filipe R. Campante & Guido Tabellini, 2008. "Why is Fiscal Policy Often Procyclical?," *Journal of the European Economic Association*, vol. 6(5), pages 1006-1036, 09.
- (4) Adi Brender & Allan Drazen, 2005. „Political budget cycles in new versus established democracies," *Journal of Monetary Economics*, 52, pp. 1271-95

## **Topic II.2. The legal environment of budgeting**

### *Content:*

The hierarchy of the legal system, typical public finance regulations at constitutional level

### *Required Reading:*

- (1) Holger van Eden & Pokar Khemani & Richard P. Emery Jr., 2013: "Developing Legal Frameworks to Promote Fiscal Responsibility: Design Matters", in: M. Cangiano – T. Curristine – M. Lazare (eds.) "Public Financial Mangement and Its Emerging Architecture, Chapter 2. pp.79-105, International Monetary Fund

*Recommended Reading:* -

## **Topic II.3. Stages, participants and documents of budgeting**

### *Content:*

the budget cycle; budget preparation; parliamentary budget procedure; main actors in the budget process (agencies vs ministries, strong vs weak finance minister, single party vs coalition government, strong vs weak legislature, unitary vs federal systems)

### *Required Reading:*

- (1) Irene S. Rubin, 1998. „Understanding the Role of Conflict in Budgeting," in: HGB Chapter 2, pages 30-52
- (2) Irene S. Rubin, 2006. „The Politics of Public Budgeting," 5th edition, CQ Press, Washington D.C. (ISBN: 1-933116-06-4), Chapter 3.

### *Recommended Reading:*

- (1) Salvatore Schiavo-Campo & Daniel Tommasi, 1999. "Managing Government Expenditures" (*hereafter MGE*) Asian Development Bank; Chapter 1: An overview of public expenditure management
- (2) Ehrhart, Karl-Martin & Gardner, Roy & von Hagen, Jürgen & Keser, Claudia, 2000. "Budget processes: Theory and experimental evidence," ZEI Working Papers B 18-2000, ZEI - Center for European Integration Studies, University of Bonn.

## **Topic II.4. Presentation of the budget and specific notions**

### *Content:*

Consequences of different presentations of the budget; reallocation (intra-year and inter years) and haircut; reporting, internal and external financial control; obligation and outlay; end year flexibility and multiyear budgeting; investment budgeting; earmarking and extra budgetary funds; budgeting for natural disasters and other contingent liabilities; cost accounting and accrual budgeting

### *Required Reading:*

### *Recommended Reading:*

- (1) MGE Chapters 2, 4, 5, 9, 11
- (2) Allen Schick, 2007. „The Federal Budget: Politics, Policy, Process,” 3rd edition, Brookings Institution Press, Washington D.C. (ISBN: 978-0-8157-7735-9), Chapter 4: The Political Rules and Arithmetic of Budgeting
- (3) Robert L. Bland & Wes Clarke, 1998. „Budgeting for Capital Improvements,” in: HGB, Chapter 26, pages 653-677
- (4) Joseph White, 1998. „Budgeting for Entitlements” in: HGB Chapter 27, pages 678-698
- (5) Marvin Phaup & David F. Torregrosa, 1998. „Budgeting for Contingent Losses,” in: HGB, Chapter 28, pages 699-719
- (6) Marvin Phaup & Charlotte Kirschner, 2010. "Budgeting for disasters: Focusing on the good times," OECD Journal on Budgeting, vol. 10(1), pages 1-24.

## **Topic II.5. Perspectives on budgetary decision-making**

### *Content:*

The normative, political, organizational and public choice approaches to the budget process: main focus and results

### *Required Reading:*

### *Recommended Reading:*

- (1) Kraan, D.-J., 1996, Introduction in: “Budgetary decisions” Cambridge University Press, pp 1-11
- (2) Persson, Torsten & Tabellini, Guido, 2002. "Political economics and public finance," Handbook of Public Economics, in: A. J. Auerbach & M. Feldstein (ed.), Handbook of Public Economics, edition 1, volume 3, chapter 24, pages 1549-1659 Elsevier
- (3) Canice Prendergast, 2007. "The Motivation and Bias of Bureaucrats," American Economic Review, vol. 97(1), pages 180-196, March.

## **Topic II.6. The use of performance information**

### *Content:*

measuring efficiency in the public sector ; spending reviews, result oriented (program) budgeting; ex post evaluation and audit; new public management; digital era governance

*Required Reading:*

- (1) MGE Chapter 15 and Annex II

*Recommended Reading:*

- (1) Teresa Curristine & Suzanne Flynn, 2013: "In Search of Results: Strengthening Public Sector Performance", in: M. Cangiano – T. Curristine – M. Lazare (eds.) "Public Financial Mangement and Its Emerging Architecture, Chapter 7. pp.225-253, International Monetary Fund
- (2) Robinson, Marc, 2011: "Performance-based budgeting - Manual", CLEAR Training material
- (3) Peter Wierds, 2004. "Expenditure Composition and Institutional Reform in Europe: a Policy Perspective," Banca d'Italia Proceedings of the Conference on Public Finance
- (4) António Afonso & Ludger Schucknecht & Vito Tanzi, 2003. "Public Sector Efficiency: An International Comparison," European Central Bank Working Paper No. 242.
- (5) OECD, 2009. „Measuring Government Activity,” ISBN: 978-926-406-072-2
- (6) Teresa Curristine (ed.), 2007. "Performance Budgeting in OECD Countries," OECD (ISBN: 978-92-64-03403-7)

**Topic II.7. Fiscal discipline**

*Content:*

The intertemporal budget constrain of the government; top-down and bottom-up budgeting, expenditure control mechanisms, reallocation; internal and external control; medium term budgeting; anchoring fiscal expectations; definition of fiscal rules; the new generation of fiscal rules

*Required Reading:*

- (1) Allen Schick, 2010. "Post-Crisis Fiscal Rules: Stabilizing Public Finance while Responding to Economic Aftershocks," OECD Journal on Budgeting, vol. 10(2), pages 1-17

*Recommended Reading:*

- (1) Agell, Jonas & Calmfors, Lars & Jonsson, Gunnar, 1996. "Fiscal policy when monetary policy is tied to the mast," European Economic Review, vol. 40(7), pages 1413-1440, August.
- (2) Barry Anderson, 2010: A spending rule is a better rule
- (3) George Kopits & Steven A. Symansky, 1998. "Fiscal Policy Rules," IMF Occasional Papers 162
- (4) Eric M. Leeper, 2009. "Anchoring Fiscal Expectations," NBER Working Papers 15269

## **Topic II.8. Transparency in fiscal policy**

### *Content:*

the notion and aspects of transparency; the role of transparency in fiscal policy (mitigate political economic problems and foster democratic participation); Procedural and substantive rules to enforce transparency, freedom of information legislation, the Open Budget Index

### *Required Reading:*

- (1) OECD, 2001. "OECD Best Practices for Budget Transparency," OECD Journal on Budgeting, vol. 1(3), pages 7-14

### *Recommended Reading:*

- (1) James E. Alt & David Dreyer Lassen, 2006. "Transparency, Political Polarization, and Political Budget Cycles in OECD Countries," American Journal of Political Science Vol. 50, No. 3 (Jul., 2006), pp. 530-550
- (2) George Kopits & Jon Craig, 1998 "Transparency in Government Operations", IMF Occasional Papers 158
- (3) Ramkumar, Vivek & Isaac Shapiro, 2013, "Guide to Transparency in Government Budget Reports: Why are Budget Reports Important, and What Should They Include? ([http://internationalbudget.org/wp-content/uploads/Government\\_Transparency\\_Guide1.pdf](http://internationalbudget.org/wp-content/uploads/Government_Transparency_Guide1.pdf))
- (4) Recommendation of the Council on Budgetary Governance, 2015, OECD Public Governance and Territorial Development Directorate

## **Topic II.9. Independent fiscal institutions and fiscal watchdogs**

### *Content:*

The possible and optimal role of independent fiscal institutions in enhancing transparency and credibility; NGOs in fiscal policy

### *Required Reading:*

- (1) Lars Calmfors & Simon Wren-Lewis, 2011: "What should fiscal councils do?", Oxford University Discussion Paper Series 537

### *Recommended Reading:*

- (1) George Kopits (ed.), 2013: "Restoring Public Debt Sustainability: The Role of Independent Fiscal Institutions", Oxford University Press
- (2) International Budget Partnership: A Guide to Budget Work for NGOs, 2011

## **Topic II.10. Government cash and debt management**

### *Content:*

Accounting and statistics of government debt and financial assets (deficit financing and change of government debt, stock-flow adjustment, revaluation); the government bond market (main investor categories, credit rating agencies, liquidity management and treasury systems); non standard



techniques (privatization; government guaranties; state owned banks and financial institutions; Public Private Partnerships)

*Required Reading:*

- (1) MGE Chapter 8
- (2) Huixin Bi & Eric M. Leeper, 2010. "Sovereign Debt Risk Premia and Fiscal Policy in Sweden," NBER Working Papers 15810

*Recommended Reading:*

- (1) Ashok Vir Bhatia, 2002. "Sovereign Credit Ratings Methodology: An Evaluation," IMF Working Papers 02/170

**Part III. Optional topics**

**Topic III.1. The role of international organizations in fiscal policy**

*Content:*

international organizations' mission; standard publications; role in the fiscal policy of member countries

*Required Reading:*

- (1) IMF World Economic Outlook
- (2) Report on Public Finances in EMU  
(selected parts from the latest issue)

*Recommended Reading:*

- (3) latest ageing report of the EU
- (4) OECD Economic Outlook

**Topic III.2. Behavioral economics in fiscal policy**

*Content:*

Basic notions of behavioral economics and some fiscal policy examples

*Required Reading:*

*Recommended Reading:*

- (1) William J. Congdon & Jeffrey R. Kling & Sendhil Mullainathan, 2011. "Policy and Choice: Public Finance through the Lens of Behavioral Economics," The Brookings Institution, Washington D.C. (ISBN: 978-0-8157-0498-0), Chapter 7 Taxation and Revenue

**Topic III.3. Fiscal federalism and fiscal coordination in the EU**

*Content:*

The Maastricht-treaty, the Stability and Growth pact and its revisions, the new rules of macro-fiscal coordination in the EU

*Required Reading:*

*Recommended Reading:*

### **Topic III.4. Budgeting in the US**

*Content:*

Based on the material of the previous three classes a comprehensive framework arises in which the budgeting system of almost any country can be described and analyzed. This framework is first presented for the US.

*Required Reading:*

- (1) Jón R. Blöndal & Dirk-Jan Kraan & Michael Ruffner, 2003. "Budgeting in the United States," OECD Journal on Budgeting, vol. 3(2), pages 8.

*Recommended Reading:*

- (1) George M. Guess & Lance T. LeLoup, (2010) "Budgeting in the United States" in: Comparative Public Budgeting, Chapter 2
- (2) MGE Chapter 1
- (3) Potter, Barry H. & Jack Diamond, 1999. „Guidelines for Public Expenditure Management," International Monetary Fund.

### **Topic III.5. Regional differences and main trends in budgeting**

*Content:*

Political, sociological and institutional differences, heritage of post-communist countries; common international trends in budgeting

*Required Reading:*

- (1) Blöndal, Jón R., 2002, Budget reform in OECD member countries: common trends, OECD Journal on Budgeting, 2, issue 4.

*Recommended Reading:*

- (1) George M. Guess & Lance T. LeLoup, (2010) "Commonwealth Countries" in: Comparative Public Budgeting, Chapter 3
- (2) George M. Guess & Lance T. LeLoup, (2010) "Budgeting in Europe and in the European Union" in: Comparative Public Budgeting, Chapter 4
- (3) George M. Guess & Lance T. LeLoup, (2010) "Central and Eastern Europe and the Former Soviet Union" in: Comparative Public Budgeting, Chapter 5

### **Topic III.6. Fiscal policy analysis in macroeconomic models**

*Content:*

The macro-econometric model of the IMF is presented in a non-technical way.

*Required Reading:*

- (1) Dennis P. J. Botman & Dirk Muir & Andrei Romanov & Douglas Laxton, 2006. "A New-Open-Economy Macro Model for Fiscal Policy Evaluation," IMF Working Papers 06/45, International Monetary Fund.

*Recommended Reading:*

- (1) Günter Coenen, Christopher J. Erceg, Charles Freedman, Davide Furceri, Michael Kumhof, René Lalonde, Douglas Laxton, Jesper Lindé, Annabelle Mourougane, Dirk Muir, Susanna Mursula, Carlos de Resende, John Roberts, Werner Roeger, Stephen Snudden, Mathias Trabandt, and Jan in't Veld\*, 2012: "Effects of Fiscal Stimulus in Structural Models", *American Economic Journal: Macroeconomics*, 4(1): 22–68
- (2) Antonio Fatas – Ilian Mihov, 2006: The macroeconomic effects of fiscal rules in US states; *Journal of Public Economics*; pp. 101-117
- (3) Jan G. Mikkelsen, 1998 "A model for financial programming" IMF Working Paper WP/98/80