The "East Jour Fixe" of the Oesterreichische Nationalbank

54th East Jour Fixe

Economic Geography / Fiscal Consolidation

The East Jour Fixe of the Oesterreichische Nationalbank, a series of meetings initiated in 1991 as a forum in which economists, members of academia, government officials and other experts on Eastern Europe meet to discuss specific transition issues, looks back on a long tradition. On March 7, 2005, this seminar series was continued with the 54th East Jour Fixe meeting on the topics "Economic Geography" and "Fiscal Consolidation."

The 54th East Jour Fixe meeting was organized in two largely independent sessions. The first session was chaired by Jarko Fidrmuc, Foreign Research Division, who introduced the topics of the meeting and the speakers of the first session. Then, Professor Joseph Francois from Erasmus University in Rotterdam presented his recent research results on the "Regional Impacts of Geographic Linkages and Agglomeration." In the first part of his presentation, Francois discussed the mechanics of economic geography in multiregion computable general equilibrium (CGE) models. He briefly reviewed the literature and addressed some modeling issues. He explained in depth how particular factors (especially market size including increasing returns to scale as well as competition and variety effects, intersectoral linkages, and accumulation and factor mobility) are treated in various types (so-called generations) of CGE models.

In the second part of the presentation, Francois discussed the application of CGE modeling to trade liberalization between developed and developing countries that constitute the current Doha Round negotiations of the World Trade Organization (WTO). Although the talks took off in 2001 (after a series of launch delays such as the meeting in Seattle in 1999), the negotiating agenda is still ambiguous in a number of crucial areas. The most important open questions include market access in agriculture, manufacturing and services. Francois sketched the complex structure of the applied CGE model of the world economy. In addition to various modeling features addressed in the first part of the presentation, in its baseline scenario the applied CGE model also takes into account the enlargement of the EU, the Agenda 2000 reforms of the CAP (the EU's common agricultural policy), the abolition of textile and clothing quotas in 2005 and China's WTO accession. He went on to detail the global effects of different liberalization scenarios in the Doha Round. Especially for developing countries, the calculated results differ greatly depending on the actual amount and coverage of liberalization. Finally, Francois presented the effects on the new Member States (NMS) of the EU. For the NMS, the CGE model implied less pronounced effects than those of EU enlargement. Yet, the agglomeration effects could yield positive GDP and export effects.

The contribution was discussed by Julia Wörz, Vienna Institute for International Economic Studies. She addressed several general modeling issues, such as the sensitivity of the calculated agglomeration effects on the amount of data aggregation, and described the results for selected sectors, e.g. textiles. Moreover, Wörz touched on the position of the developing countries in the negotiations. The general discussion focused on the implications of the Doha Round especially for the NMS.

The second session was chaired by Peter Backé, Head of the Unit for Central and Eastern European Analysis, and focused on public finance issues in Central and Eastern Europe. Philipp Rother, Principal Economist in the Fiscal Policy Division of the European Central Bank, presented a paper on "Fiscal consolidations in the Central and Eastern European countries," which he coauthored with António Afonso and Christiane Nickel, and which has been published as ECB Working Paper No 473 in the meantime. On the basis of logit models for the period from 1991 to 2003, Rother discussed the determinants of success probability of fiscal consolidations in the individual countries of the EU-15, the eight NMS from Central and Eastern Europe as well as two candidate countries (Bulgaria and Romania). Consolidation events were defined as substantive improvements in fiscal balances adjusted for the impact of cyclical effects.

The results seem to suggest that for these countries expenditure-based consolidations have tended to be more successful than revenue-based consolidations. Rother showed that the results are robust to alternative thresholds for the identification of fiscal events and composition dummies. Interestingly, the results differ from those for the EU-15, where composition dummies remain generally insignificant. Rother conjectured that the results for CEECs could be explained by an inability to increase revenue ratios above already high levels due to a lack of administrative capacity.

The paper was discussed by Ludwig Strohner, an economist from the Institute for Advanced Studies (IHS) specializing in public economics and tax issues. He reviewed the macroeconomic effects of fiscal consolidations, with a particular focus on expansionary fiscal contractions. Strohner examined the definition of successful consolidation used by the authors, the issue of intended fiscal consolidations versus actual fiscal consolidation events as well as announcement and timing effects.

In the subsequent general discussion, it was pointed out that most of the consolidation events captured in the paper took place in the mid-1990s and were associated with cuts in subsidies to enterprises during their privatization and, in some cases, also with reductions in defense spending. Against this backdrop, the question arose to what extent one could draw conclusions from the consolidation efforts undertaken a decade ago for the design of future fiscal contractions in Central and Eastern Europe. Also, it was argued that the paper may have captured the discontinuation of temporary expenditures (e.g. on banking consolidation) or the reduction of interest payments (due to the use of privatization revenues to pay off public debt) as expenditure-based fiscal consolidation events, which might be debatable. Moreover, it was suggested to extend the analysis to periods prior to fiscal stabilizations and to episodes of fiscal loosening and their composition in terms of revenues and expenditures.