

# Does Fiscal Reform Change the Revenue-Expenditure Nexus? Evidence from Some OECD Countries

Tomomi Miyazaki\*

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## **Abstract**

Many OECD (Organization for Economic Co-operation and Development) countries have run government deficits since the mid-1970s. To consolidate government budgets, policymakers experiencing fiscal problems have had to reduce their budget deficits in the 1980s and the 1990s.

Especially in the 1990s, some countries reformed fiscal institution. For example, in 1995, Sweden decided to adopt expenditure ceilings. After 1996, Australia set limits for annual expenditures based on forward estimates, and this Australian rule has been legally conditioned on the Charter of Budget Honesty Act established in 1998. As far as other countries are concerned, Japan conducted fiscal reform from 1997 by enforcing the Fiscal Structural Reform Act; however, the act was suspended in December 1998. Further, in 1998, the UK introduced the fiscal rule named as the Code for Fiscal Stability. On the other hand, the Netherlands has set government expenditure rules based on the agreement of parties which form a ruling coalition since 1994.

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\*Faculty of Economics, Toyo University. E-mail: *t\_miyazaki@toyo.jp*

Above all, both Australia and Sweden had been classified as countries with “fragile” budgetary institutions in the sense that there had not been an expenditure ceiling or any procedural rules in the budget negotiation process, according to the survey conducted until the mid-1990s. On the other hand, earlier surveys have classified the UK and the Netherlands as countries with expenditure ceilings and a strong position occupied by the Prime Minister or Finance Minister in the budget negotiation process. Compared with the reforms conducted in countries with primitive expenditure ceilings or strong fiscal authorities, the reform conducted in Australia and Sweden is the one that has fundamentally altered their “fragile” budgetary institutions. Moreover, unlike the Japanese Fiscal Structural Reform Act, the reforms in these countries set “permanent” expenditure ceilings. Based on these arguments, the reforms conducted in Australia and Sweden in the mid-1990s should be called as “permanent” budgetary institutional reforms.

In both Australian and Swedish reforms, the expenditure ceilings are determined. Then, the restraint of government expenditures may change the revenue-expenditure nexus of the government budget. Incidentally, the problems with the revenue-expenditure nexus of the government budget have been discussed as sustainability problems of budget deficit or public debt. Based on these point, the adoption of a “permanent” expenditure ceiling in both Australia and Sweden can be understood as the “structural change” in the revenue-expenditure nexus of the government budget in that it may help the government reduce budget deficit through the restraint of government expenditures, thereby enhancing or restoring the sustainability of budget deficit or public debt.

Based on this point, the objective of this research is to examine how the adoption of a “permanent” expenditure ceiling affects the sustainability of budget deficit or public debt through the restraint on public expenditures. To do so, both Australia and Sweden have been selected because these two countries have adopted the expendi-

ture ceiling since the mid-1990s, compared with other countries such as those that set originally expenditure rules or “temporary” reforms. An approach that involves examining the cointegration relationship between fiscal variables is adopted. Moreover, since the influence of fiscal reform is being examined by calculating the coefficient of the fiscal variable with a structural break, the dynamic OLS (hereafter DOLS) approach developed by Stock and Watson (1993) is employed, as in the case of Ahmed and Rogers (1995) and Baharumshah and Lau (2007).

## References

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