Guillermo E. Perry, Luis Servén, and Rodrigo Suescún (eds.). *Fiscal Policy, Stabilisation, and Growth: Prudence or Abstinence*? Washington, D.C: The World Bank. 2008. Paperback. 329 Pages. Price not Given.

'Fiscal Policy, Stablisation, and Growth' edited by Guillermo Perry, is an excellent volume covering the typical but current debate on "Does Fiscal Policy Matters". The book highlights the procyclical and anti-investment biases embedded in fiscal policies, explores their causes and macroeconomic consequences. The text provides empirical substance to the theoretical models and offers policy and recommendations, to help overcome the procyclicality and anti-investment biases of fiscal policies adopted thereof. With wide range of technical and empirical discussions, political economy aspects of the budgets have also been examined. Though the focus of the book is Latin American and the Caribbean countries, the debate is so holistic that it can be used for policy recommendations else where as well.

The book is organised in two parts; the first part, spread over four chapters, covers the procyclicality of Fiscal policy while the Part II, comprised of five chapters, elucidates the impact of fiscal policy on economic growth. The discourse takes into account the fiscal policy solvency condition and its imbedded biases towards certain policy options.

Chapter 1 provides an excellent overview of what is discussed in the volume. The book argues that excessive focus of fiscal agents on short term indicators of fiscal health, namely the government debt or cash flows, may detract attention from tracking the inter-temporal solvency. Such detraction will affect the macroeconomic stability and long-term growth, argues the book. Perverse incentives, that have political economy context, are at the root of flawed policies such as procyclical policies, contends the book.

Chapter 2 explains the nexus of Fiscal discipline, volatility and economic growth. Specifically, the role of fiscal instruments such as automatic stabilisers is the focus of debates. The authors have empirically examined the impact of institutions versus restrictions on fiscal policy. They validate the popular belief that fiscal policies contain discretionary components which cause business cycle volatility and hamper long-term economic growth. Finally they conclude that developing fiscal institutions and ensuring enforcement of fiscal discipline are feasible and politically viable. This would not only furnish the restrictions required but also provide enough flexibility to reduce the cost of restrictions.

Chapter 3 is about the size and effectiveness of automatic stabilisers, in the Latin American and the Caribbean (LAC) region. Competing theories of 'let the automatic fiscal stabilisers work'and 'discretionary fiscal management' have been empirically examined. The author develops a theoretical steady state model of a small open economy with households, firms and government. The setting is dynamic and stochastic with possibility of multiple shocks. The automatic fiscal stabilisers for LAC region are found to be small as compared to the industrial economies. These stabilisers are also found to be non-responsive to economic cycles in the LAC region. This shows that adoption of fiscal rules such as Maastricht Treaty and Stability and Growth Pact is not a viable policy option for LAC economies.

Chapter 4 of this edited volume critically examines the role of procyclical fiscal policies and fiscal federalism as a case study for Argentina and Brazil. To begin with cross country data is examined in the context of procyclicality of fiscal balances (e.g.

budget surplus). Preliminary examination shows that the developed economies tend to behave in a typical procyclical manner as predicted by Keynesian-New Growth model however, the data suggests that, developing and emerging economies do not behave in this fashion. The author develops a model of fiscal federalism and tests the same for Argentina and Brazil. The interesting portion of his analysis is where the authors tries to capture the issue of procyclical government spending across sub-national governments in these two Latin American countries and found that these sub-national governments follow the footsteps the central governments. Although they found that it is not attributable to federal transfers only. Finally the authors recommend that fiscal institutions should be promoted to reduce the degree to which the procyclical tax base becomes the part of government expenditures.

Chapter 5 evaluates the performance of fiscal rules and also examines the improvement in the issue of fiscal balance being procyclical. The author argues that there is a trade-off between letting the automatic stabilisers work on the one hand and the fiscal consolidation on the other hand. He develops the argument by emphasising the need for procyclical fiscal policy to achieve welfare objectives, but at the same time stresses the creation of ambiance for well-designed fiscal rules. A procyclical fiscal policy may exacerbate volatility and cause huge deficits as well. This in turn calls for fiscal adjustments, which if practiced has a negative impact on investment and hence growth. He traces the procyclicality of fiscal balances to faulty policies, weak budgetary institutions, asymmetric information and problems with international financial markets. The author argues that adopting automatic rules may allow fiscal stabilisers to work over the business cycles and pave the way for rules-based countercyclical policies. He cautions, however, that adopting a rule may lead to the dilemma of choosing between flexibility and credibility. With rigid rules the fiscal stance may be over-tight and in certain circumstances may continue to be procyclical. On the other hand allowing for flexibility may impinge upon the credibility of authorities. Finally while reviewing the performance fiscal rules in Latin America, the author concludes that setting a rule, based on the goal of structural balance may help in letting the automatic stabilisers do their job, and still avoid sharp changes in public expenditures, that are associated with changes in revenue receipts.

Part II (chapters six to ten) of the book covers the core issue of fiscal policy and economic growth. Chapter six revolves around the nexus fiscal discipline, public investment and growth. The author argues that solvency of the government is typically gauged against cash deficit while public assets and or future income stream of public sector are ignored altogether in this regard. He points out that fiscal adjustment programs adopted on the basis of such flawed indicators had led to excessive cuts in public investments. The author favours the determination of fiscal solvency on the basis of budgetary components rather against consolidated budget. The rationale is that productive expenditure generate returns in future as well while non-productive expenditures do not. Therefore, the author argues, the two types of expenditures should not be treated at par while designing fiscal rules to protect solvency. The author also recommends that the government should not involve itself in sectors where the private sector has a comparative advantage. The implication is that retracting from such sectors would provide fiscal space to the government and will minimise the need for fiscal adjustment.

Chapter 7 informs the reader as to how only a change in accounting method of recognising expenditures may allow an increase in public investment while remaining within the limits specified by fiscal rules? The authors argue for accrual accounting rather cash accounting to determine budget deficits. As the accrual accounting spreads the capital expenditure over the useful life of the assets therefore the budget deficits, determined under accrual accounting, would not only be lesser but realistic as well. The principles of tax smoothening and intergenerational equity have also been discussed with reference to capital budgeting and debt. After discussing the pros and cons of debt finance capacity of the government, the authors recommend that commercially viable (self liquidating) capital expenditures be partially funded through debt and the rest be financed from operational budgets.

Chapter 8 is about the possibility of improvement in Stability and Growth Pact (SCP) through the use of better accounting methods for Public Investment. Given the failure of the pact in restricting demand as reflected by high deficits across some member countries, the authors suggest some improvements in the Pact. The authors recommend that pact should treat the debt financing of projects with high social return differently and intergenerational transfers should be taken into account. The possibility of what type of investment to include in the balance budget rule and what to ignore is discussed rigorously. The authors also recommend the setting up of public investment agencies under the principles of good governance.

Chapter 9 critically evaluates the accrual accounting method and its impact on long term fiscal projections. The author stresses upon the need for having a long-term view of government expenditures as opposed to the mere focus on the traditional fiscal indicators. In this regard the merits and demerits of accrual accounting are discussed at length. He also argues that cash based accounting compels the analyst to focus on short term benefits and thus long term benefits of self liquidating projects are over shadowed. He recommends that for determining the solvency of a government, the use of fiscal indicators should be supplemented by information on the value of government's physical assets, net worth and the change in net worth year on year basis. In this regard the use of Government Finance Statistics Manual 2001 prepared by IMF is recommended. Moreover preparation of financial reports according to the standards of International Public Sector Accounting Standards Board is also recommended.

The tenth and final chapter of the book examines the impact of infrastructure on growth in Brazil. Capital formation in public sector has been declining over the last 25 years and this had adverse repercussions for all of the sectors of the economy. After presenting some stylised facts about the issue, the authors develop an argument in favour of increased investment on infrastructure by the public sector through debt financing. Based on their simulation results, the authors recommend that public investment in infrastructure should be increased for revenue generating projects and for such projects that contribute to increase the productivity in the private sector.

To sum up this is an excellent book for all those interested in fiscal management. I strongly recommend the book to fiscal managers and researchers in particular and students of fiscal policy in general.

Mahmood Khalid

Pakistan Institute of Development Economics,
Islamabad.