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**THE NEW ORTHODOXY IN BUDGETARY PLANNING:
A CRITICAL REVIEW OF DUTCH EXPERIENCE**

by

J. DIAMOND



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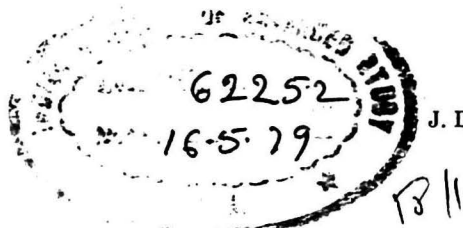
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THE NEW ORTHODOXY IN BUDGETARY PLANNING:
A CRITICAL REVIEW OF DUTCH EXPERIENCE*

by

J. DIAMOND**



I. INTRODUCTION

The past decade has seen the emergence in many advanced countries of a "new orthodoxy"¹ in budgetary practice: namely, the attempt to relate the growth in public sector to the growth in the economy as a whole. This has in part been a result of increased scepticism at the undue emphasis placed in economic thinking on the functions of the budget as an economic regulator, to the neglect of its more traditional function as a mechanism for the transfer of resources from private to public use. In part it has also been due to dissatisfaction with conventional Keynesian stabilization policy with its emphasis on short-run problems of demand management. As countries gained experience in operating discretionary fiscal policy the inherent difficulties of "fine-tuning" have become ever more apparent — the political and economic disadvantages of frequent variations in taxation and spending were found to be wasteful of resources, and, due to operational lags, destabilizing in their own right.

This has resulted in an attempt to reconcile the question of allocation from that of stabilization by means of simple budgetary guidelines specifying the "desired" relationship between the growth in public spending and the development of the economy as a whole. These rules are then used as a long-run benchmark to measure the anti-cyclical departures of active fiscal policy. Without denying that such procedures are invaluable in clarifying priorities between private versus public wants, the control aspects of such practices have ramifications for economic policy as a whole which are seldom fully recognized. For example, the operation of any simple rule seems to involve inevitable conflicts between the "allocative" and "stabilization" functions of the budget which are rarely made explicit. Also, the move from short-run to medium term budgetary planning indirectly involves a fundamental

re-appraisal of the scope of economic policy. Generally, this has resulted in a change in emphasis away from discretion to control in budgetary procedures, as well as a parallel move away from active fiscal policy to automatic stabilization. Because of these repercussions, economists should be concerned with the economic rationale of such budgetary guidelines lest the supposition spread, especially among politicians, that these institutional devices are adequate substitutes for rational policy decisions.

Of course, countries have differed in the degree to which they have adopted this new budgetary orthodoxy. Although most of the EC countries now present medium-term as well as short-term national budgets, the strictness of the adherence to budgetary rules and the reliance on automatic stabilization vary greatly among countries. The Netherlands are unique in being a pioneer of this new budgetary practice through their structural budget margin procedure, which still represents the strictest adherence to the "new orthodoxy". Other countries have partly moved in the same direction. In the USA the "high employment surplus" measure is used to separate discretionary from automatic budgetary changes around some full employment growth path.² In the UK, since the Plowden Committee Report, there has been a move to tie the growth in public spending to the growth in available resources, through the "productive potential" indicator.³ Germany has also adopted budgetary guidelines relating the growth in public spending to the growth in potential GNP measured at full employment capacity.⁴ Dutch experience, however, seems particularly relevant since it has operated medium-term budgetary planning longer than most countries. For this reason it is hoped that an analysis of its experience in operating the structural budget margin (SBM) rule will provide some lessons for other countries.

II. THE UNDERLYING STRUCTURAL BUDGET MARGIN APPROACH

To understand the origin of the "structural budget margin" (SBM) one must appreciate the widespread disillusionment with Keynesian budgetary policy which heralded the adoption of this procedure in the 1960s. The Dutch felt that heavy reliance on discretionary fiscal policy produced a built-in inflationary bias in the economy, not only for the reasons usually quoted (*viz.*, absence of markets, unlimited borrowing capacity, the operation of pressure groups), but also because of the special characteristics of the Dutch political system which resulted in a succession of coalition governments giving each minister undue scope for advocating and maintaining spending increases, unconstrained by a strong cabinet government. Secondly, it became accepted that there had been too much concentration on the short-run cyclical aspects of expenditure policy with concern expressed about the effects on business confidence of sudden changes and the wastefulness of cutting expenditures

at short notice (with capital rather than current spending typically being hardest hit). Thirdly, the technical and operational difficulties involved in discretionary cyclical adjustments gave cause for concern: in particular, it was felt that such adjustments resulted in destabilizing effects because of time lags.⁵

The political setting for the adoption of the SBM is also important. As a result of the 1959 elections, held in the wake of popular outcry against rising tax burden and balance of payments deficits, for the first time since the War a non-socialist Minister of Finance, J. Zijlstra, came to office. The first priority of the new government was to lower the tax burden and correct the balance of payments situation. With this aim in mind, changes were instituted in budgetary practice stressing the control aspects of the budget and, as a result of this, a re-appraisal of the economic aspects of budgetary policy took place. Emphasis shifted to the medium-term planning of government expenditure and taxes, and away from short-run counter-cyclical tactics. With this change heavier reliance was placed on automatic stabilization and less on discretionary policy. The SBM thus represented an attempt, largely from a political standpoint, to impose a macro-economic constraint on the growth of government expenditure — one to be determined by the trend-based growth in the economy, *not* the actual growth. Such a "margin" was to represent an upper limit on the funds available to the government either to increase expenditure or reduce taxes.

Originally, the determination of the size of the SBM was fairly simple, at least in principle. First, a decision is made on the trend-based growth rate in real output, y . In practice this has been calculated on the basis of estimates of the probable increase in the labour force and its productivity, the structural growth rate representing their product.⁶ Secondly, assuming output actually expands along this structural growth path, an estimate is made of the automatic growth of taxation. This depends, of course, on the magnitude of y and the elasticity of the tax system, e (the so-called "progression factor", assumed greater than unity). Finally, an estimate is made of the actual growth in non-tax revenues, ΔNTR . The margin in time period 1 is then except for a possible adjustment of the budget deficit, given by:⁷

$$(1) \quad M_1 = y \cdot e \cdot T_0 + \Delta NTR$$

where M_1 = the SBM in time period 1;

T_0 = level of taxes in base period 0;

ΔNTR = growth in non-tax revenues between periods 0 and 1.

A simple numerical example may help illustrate the method. Let $y = 0.048$ (i.e., the structural growth rate = 4.8 %); and let $e = 1.25$ (i.e., the elasticity of the tax revenue with respect to income is 1 1/4); and assume for illustration purposes that

TABLE 1

Estimation of the SBM 1962 — 1976

Year	(1) Trendbased Growth of Tax-revenues	(2) Actual Increase in Non- tax-reve- nues	(3) Adjustment Budget Deficit	(4) Other Factors (1)	(5) Effects of Tax Measures (2)	(6) Margin Available for Expendi- ture Increase
(Million Guilders)						
1962	500 ³	— 4			— 200	300
1963	500 ³	— 4			— 200	300
1964	600 ³	— 4			— 175	425
1965						470 ⁵
1966	900 ³	— 4			+ 527	1.427
1967	1.120 ³	268			+ 45	1.433
1968	1,250 ³	215		— 75	+ 505	1.895
1969	1,250 ³	305		— 90	+ 88	1.553
1970	1,360 ³	230		— 202	+ 305	1.693
1971	1,410 ³	521		— 238	+ 398	2.001
1972	1.600	715		+ 20	+ 395	2.730
1973	1.570	660		— 186	+ 794	2.838
1974	1.900	1.120	+ 525	— 491	+ 830	3.884
(1,000 Million Guilders)						
1975 ⁶	8,9	3,8	+ 1,7	— 0,4	— 2,5 ⁷	11,5
1976 ⁶	6,8	3,3	+ 0,4	— 0,5	+ 0,4 ⁷	10,4

Source: Netherlands Budget Memoranda

Notes:

¹ Mainly claims on the budget margin (—) on account of an increase of transfers to the Municipalities and the Provinces Fund and the E.C.

² Decrease of taxes = —
Increase of taxes = +

³ Including a calculated trend-based growth of the non-tax revenues
1962–1964: trend-based growth rate ($5 \frac{1}{3} \% \times$ non-tax revenues 1961)
1965: See note 5
1966: 100 million
1967–1971: 150 million per annum

⁴ Not taken into account.

⁵ In the Netherlands Budget Memorandum 1965 only the margin available for an increase of the net-relevant expenditure is calculated.

⁶ Since 1975 the total margin method has been applied.

⁷ For 1975 and 1976 including the decrease of taxes account of the inflation adjustment with regard to the wages and salaries taxes.

$T_0 = 1000$ and $\Delta NTR = 40$. Then the budget margin in period 1: $M_1 = (0.048) (1.25) \cdot 1000 + 40 = 100$. The derivation of the actual budget margin for the period 1962–1975 is shown in Table 1 above.

This standard, (sometimes called the “Zijlstra standard”), as originally conceived, had certain distinctive features. The first feature of the SBM is that no specific division of the margin between expenditure and taxation is presumed, although the original intention of the government was to hold increases in public expenditure to the structural growth rate. Thus the margin calculated above can be used for increasing spending by 100 or reducing taxes by the same amount, or a combination of the two as in the following cases:

Case a: increase $G = 20$, reduce $T = 80$, total effect = 100;

Case b: increase $G = 80$, reduce $T = 20$, total effect = 100;

Case c: increase $G = 120$, increase $T = 20$, total effect = 100.

The latter case illustrates a further alternative of raising tax rates and thus enabling an increase of spending above the margin.

The second feature of the SBM rule worth stressing is the importance of determining the size of the “acceptable” structural deficit — that public deficit will just compensate for the leakages out of the spending stream from the other sectors in the economy and hence maintain the economy on its structural growth path. It can be expected that deficits and surpluses in the other sectors will not increase in proportion, indeed experience suggests that the base year deficit tends to become too small as national income increases. The “actual” structural budget deficit is the deficit that results from the assumption that trend-based budget policy will continue unchanged. Some adjustment will be required to bring the “actual” structural deficit in line with the required or “acceptable” structural deficit. For example, if the budget deficit expressed as a percentage of the national income remains constant, the SBM would be calculated as:

$$(2) \quad M_1 = y \cdot e \cdot T_0 + \Delta NTR + y_a \cdot D_0$$

where y_a = *actual* real growth of national income, and D_0 equals the budget deficit (excluding amortization) in the base period 0. Hence the SBM in period 2, excluding for the moment the actual increase in non-tax revenues and the proportional growth of the budget deficit ($y_a \cdot D_0$), will be:

$$(3) \quad \begin{aligned} M_2 &= y \cdot e (1 + y \cdot e) T_0 \\ \text{or} \\ M_2 &= (1 + y \cdot e) M_1 \end{aligned}$$

The shift to a deficit constant in relative terms was made in 1973, by then, however, up to and including 1974 the margin was being calculated in money terms

rather than in real terms. A distinctive feature of the original "Zijlstra standard" was that the SBM was to be measured in real terms at the price level prevailing at the base period and then adjusted for any deviation from the actual price level. While in the early years it was possible to calculate the SBM using y in real terms only, the influence of inflation could not be ignored. It became increasingly important to take into account the tax revenues resulting from the purely nominal increase in national income as a consequence of inflation. Thus the total growth in tax revenue is given by:

$$\Delta T = (y + p + py) T_0$$

where p equals the price rise in national income. This additional element can be absorbed into the SBM calculation in the following fashion:

$$(4) \quad M_1 = e(y + p + py) T_0 + \Delta NTR + (y + p + py) D_0$$

Another obvious complication arose from the inclusion of non-tax revenues which were inevitably measured in money terms. These have been treated in various ways over the years.⁸ (See Table 1, note 3). Sometimes an estimate of these revenues was added to the budget margin *ex ante* and any deviation of this estimate from the realized amount was adjusted at a later stage. For a short period the "net method" was applied: non-tax revenues were compared with expenditures in the same field and only the net increase in spending was tested against the budget margin. This method was soon abandoned in favour of adding the full increase of non-tax revenue to the budget margin. Although this simplifies the estimation of the SBM, this does mean an explicit policy decision is incorporated into the calculation of the margin.

Evidently then, the SBM methodology has evolved over the years of its implementation and the rather simple original rule has been complicated in several ways when put into practice. Three complications in particular require examination: the identification of the structural growth rate; the definition of the "irrelevant" expenditures; and the impact of inflation.

III. OPERATIONAL DIFFICULTIES

Obviously the definition of the structural growth rate is of prime importance for the operation of the SBM. This has been carried out by comparison with past growth rates and forecasts of medium-term growth potential, the aim being to estimate the likely growth in the labour force and its productivity. Given the difficulties of defining these concepts, let alone measuring them, inevitably some scope for discretion arises, and changes in the value of the structural growth rate have occurred. For example, between 1961–1965 the rate was put at 4% but this was revised continuously upwards throughout the 1960s, but in the 1970s the trend was reversed.⁹ An equally difficult decision involves the choice of base year (i.e., to decide

on T_0).¹⁰ A minor difficulty arises over whether public employees should be included or excluded in the estimate of the increase of the labour force. This has been resolved in favour of using estimates of labour absorption net of that required in the public sector (i.e., that available for the private sector). However, more fundamental criticisms arise from the use of a crude labour-based yardstick and the suspicion that its adoption avoids having to face a potentially embarrassing question: what happens if the "structural" growth rate corresponds to an output level different from the full employment growth path?

A certain amount of practical expediency has characterized the definition of relevant expenditures to be measured against the standard. Exemptions from the SBM can be divided into three categories: i) those expenditures which have little impact on the economy; ii) those required for discretionary fiscal policy; iii) those which may have an impact on the economy and therefore whose exclusion is contentious.

The first category includes those expenditures which do not involve a claim on real resources. For example, monetary transactions with the IMF, and payments to the Central Bank as compensation for its losses in revenues due to revaluation. Also included here are the expenditures resulting from *virement* which merely represents a shift in resource use between levels of government usually associated with changes in their share of tax revenues.¹¹

The second category reveals what is, potentially at least, the most important loophole in the budgetary discipline imposed by the SBM. In practice, however, such expenditures have been relatively small, although 1971 saw the introduction of a fiscal regulator which allows the Minister of Finance discretionary changes in the five main taxes by up to 5 % which legally has to be combined with an opposite change in public expenditure (minimal 1/5 of the change of taxes). Also there has been the tendency in the past for temporary special programmes aimed at stimulating employment and increasing unemployment benefits to accumulate and bias temporarily the budget deficit above its "structural" level. These were financed out of the budget but outside the margin. To remedy this steps were taken in 1974 to include a part of such outlays in the SBM test.¹²

Undoubtedly, tricky problems are posed for SBM policy by the final category: expenditures which might have an impact on the economy. Perhaps the least contentious is that of debt redemption. It can be argued that since the government has it in its power to borrow back these resources it can frustrate any increase in spending in other sectors of the economy. At the same time large redemptions in any year may leak out through the capital market to finance investments elsewhere. Investment in the share of partly owned state enterprises in theory may also be considered "irrelevant", when they are offset by an equivalent fall in investment in

the private sector. In practice, however, they are nearly always taken into account with regard to the budget margin. A similar reasoning is applied to any shift of expenditures from the private to the public sector (or *vice versa*), it being argued that any change in the deficit in the public sector is offset by an equivalent change in the private sector surplus. This simple one-to-one balancing between sectors appears something of a simplification, although probably justifiable on practical grounds. Practical expediency also characterizes the treatment of local authorities in the SBM policy. While they are incorporated into the other sectors for the purposes of the SBM calculations, some 90 % of their current income originates from the central government. This is financed in two ways: either out of earmarked transfers, in which case they are treated just like any other central government expenditure inside the margin; or from non-earmarked transfers, in which case they are not included in the SBM. The latter source of finance comprises approximately 15 % of total government tax revenue.

As originally formulated the SBM derived in real terms at the price level of the base period needs to be adjusted for inflation in the intervening period. Unfortunately, inflation does not have equivalent effects on both sides of the public account. On the revenue side, given the progressivity of the tax system, then the faster money incomes rise due to inflation, the greater will be the increase in tax revenues causing an increased real tax burden. At the same time, non-tax revenues, which are included in the SBM, are expressed in money terms and also tend to increase with inflation. On the expenditure side, the cost of providing goods and services, particularly in meeting the general increases in wages and salaries, makes it at least within a real budget margin difficult to maintain the same output of public services in real terms. From the viewpoint of counter-cyclical policy it would seem desirable to express the SBM in real terms and so reinforce the automatic stabilization aspect of the rule. However, given the existence of cost-push as opposed to demand-pull inflation, and given the rigidity of prices downwards, then it has been argued, sticking to the budget margin in real terms may be excessively deflationary.

Faced with increasing inflationary pressure in the 1970s, the Dutch have had to employ a number of "rules of thumb" for their solution. Remembering that the growth in tax revenues resulting from the combined effects of real structural growth rate, y , and the inflation rate, p , is given by:

$$e(y + p + py) T_0$$

then this total can be divided into three "compartments":

- Compartment I : $e \cdot y \cdot T_0$, equal to the real budget margin;
- Compartment II : $p(1 + y) T_0$, equal to the proportional nominal margin;
- Compartment III : $(e - 1) \cdot p \cdot (1 + y) T_0$, equal to the extra nominal margin due to the elasticity of the tax system greater than unity.

A system of earmarking was then applied. Compartment I, representing the real margin was considered available for increased spending (excluding general increases in wages and salaries and some other non-relevant items) or tax reduction in the normal way. Compartment II, proportional to the rate of inflation, was earmarked for meeting general increases in salaries in the public sector. Fortunately, over a number of years there appeared some equality between the two. Compartment III, representing the combined influence of inflation and the progressivity of the tax system was reserved for downward adjustment in income tax rates due to rise in prices. The system of earmarking is outlined in Table 2 below.¹³

TABLE 2
System of Earmarking in SBM Policy

Increase in Revenue		Earmarked for:	
COMPARTMENT III	Purely Nominal due to Progression	Nominal Revenue From Taxes	Adjustment of Rates of a Number of Taxes due to Rise in Prices
COMPARTMENT II	Proportional Part of Purely Nominal Growth		General Increase in Wages and Salaries
COMPARTMENT I	Real, due to Progression	Real Revenue from Taxes	— Increased Gross Expenditure, Excluding General Increase in Wages and Salaries and Some Other Non-relevant Items — Tax Reduction
	Proportional Part of the Real Structural Growth Rate		
	Actual Growth in Non-tax Revenue	Non-tax Revenue	

A number of difficulties were encountered in operating this system. Using the real margin in a period of rapid inflation, as measured by Compartment I, made it increasingly difficult to maintain public spending in real terms. For although the costs of wages and salaries were excluded from the test, in a period of pronounced

inflation increased costs apart from direct wage costs become difficult to meet. At the same time, this rigid compartmentalization was felt to interfere with the content of public spending. Besides the additional direct wage costs for programmes which were wage-sensitive (the so-called wage-sensitive expenditure; budget items, or parts of them, which are directly affected by general salary adjustments or by increases in industrial wages, which category represents 50 % of all government expenditure) were excluded from the real budget margin test. While it can be argued that wage increases should be excluded since the government has no choice but to accept them, it is not surprising that this pragmatic solution has not been wholly acceptable. The counter-argument is that any such increases should not be overly inflationary and hence should be covered by taxation.¹⁴ These doubts about the treatment of wage and salary increases and the earmarking system were reinforced by the surpluses discovered in Compartment II. With a high rate of inflation the proportional nominal margin began to exceed the increase in the wage bill and thus led to a reduction in the structural budget deficit and unintended fiscal drag.

The difficulties encountered with this system of earmarking in a period of rapid inflation, as well as the complexity introduced into the SBM calculations, has caused this system to be abandoned recently. In its place a unified budget margin in nominal terms has been adopted. However, this move towards a SBM measured in monetary terms (as in equation (4) above), does involve problems. Now apart from a decision about the year (T_0), the real structural growth rate (γ), and the elasticity of the tax system (e), a new important factor emerges — the estimate of p , the rate of inflation. In the Budget Memorandum of 1975 the Ministry of Finance opted for an estimate of p based on forecasts of the most likely inflation rate realisable.¹⁵ This poses the practical problem of how to deal with deviations in price rises occurring during the fiscal year, as well as procedural problems, such as how to make the price adjustment explicit and so reinforce the disciplinary aspects of the SBM without suggesting government acquiescence in price and wage increases. The above problems are difficult to solve, and in the process of dealing with them the simplicity of the SBM rule is likely to be compromised.

Such qualifications and adjustments thus suggest two fundamental problems for SBM practice. First, despite appearing to be a very simple rule governing the increase in government expenditure and receipts, there is in fact a good deal of operational discretion involved in practice. For instance much depends on the definition of the acceptable size of the structural budget deficit, the structural growth rates, the base years, and the expenditures to be included in the test.¹⁶ Secondly, the complexity of computation and frequent modifications may undermine the whole idea of a simple budget rule operating to control the growth in government expenditure — for discipline to be effective a simple and easily comprehensible rule is needed.¹⁷ For

instance, some have seen the revisions in base year and the adjustments of structural growth rate and progression factor as an attempt to escape from the discipline of the SBM philosophy; the treatment of inflationary wage increases and the exclusion of certain categories of expenditure is similarly suspect.

How effective has the SBM policy been? In assessing the effectiveness of the SBM procedure it is important to distinguish between the different claims made on its behalf. Subsidiary aims have been its stabilization function, countering cyclical tendencies in the economy, and also reducing the need for discretionary fiscal policy. However, this is not the place to go into the effectiveness of economic policy in the Netherlands, which is perforce a rather complicated matter. In any case, first and foremost the SBM procedure was introduced to control the growth in the public sector. It will also be remembered that Zijlstra's intention was to cut the tax burden and restrict public spending which was felt to be too high. The experience from this viewpoint is summarized in Table 3. The margin available annually for expenditure increases or tax reductions is shown in column 11 of Table 3. When this is compared with the increase in spending actually budgeted for, (Table 3, col. 2), it is evident that even *ex ante* spending has been in excess of the margin for a number of years. Further, from column 3 it is evident that *ex ante* over-spending has been of greater magnitude than *ex ante* under-spending over the period under study. However, after adjustment for autonomous tax changes and the growth in non-tax revenues, the record of over- and under-spending *ex post* appears rather more uneven. From column 8 of Table 3 it is evident that in the early period of SBM policy *ex post* spending was considerably in excess of the prescribed margin, in some cases by amounts as large as the budget margin itself. Such consistent one-way deviations must throw doubt on the controlling influence of the SBM policy in this initial period. After 1966, however, there has been a greater tendency to under-spend *ex post*. Moreover, the *ex post* deviations as a percentage of the SBM have declined over the years, indicating that as the SBM procedure has evolved its control effectiveness has increased. In this evaluation it should be remembered that the results recorded in Table 3, column 3 are essential for the interpretation of the structural developments, because only the over- or under-spending mentioned there has its impact on the following years. This follows from the fact that the claims on the budget margin are being measured by comparing the successive draft budgets. In contrast to this, the difference between columns 3 and 8 has only meaning for the year concerned (and thus in that respect it has a "conjunctural" character).

IV. A CRITIQUE OF THE BUDGETARY PRINCIPLES OF THE SBM

It will be remembered the political motivation behind the implementation of the SBM policy lay in the inflationary bias thought to exist in government opera-

TABLE 3

Over- or Underspending of the SBM 1962-1976

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Year	Margin Available for Ex- pendi- ture Increase	Relevant Expendi- ture Increase	Over- or Under spending ex ante	Differences between Draft Budget and Account Figures				Over- or Under- spending ex post
				Expendi- ture	Non-tax- Revenues	Effects of Tax- measures	Other Factors	
(Million Guilders)								
1962	300	445	+ 145	+ 59				+ 204
1963	300	294	— 6	+ 113				+ 107
1964	425	559	+ 134	+ 347				+ 481
1965	470	436	— 34	+ 765				+ 731
1966	1.427	1.813	+ 386	+ 145		+ 180		+ 711
1967	1.433	1.427	— 6	+ 311	+ 82	— 535		— 148
1968	1.895	2.018	+ 123	— 225	— 24			— 126
1969	1.553	1.514	— 39	— 468	+ 12	— 133	— 40	— 668
1970	1.693	1.651	— 42	+ 147	— 96	— 38	— 31	— 60
1971	2.001	1.919	— 82	+ 514	+ 237	— 35		+ 134
1972	2.730	2.730	—	— 44	+ 47			— 3
1973	2.838	2.838	—	— 733	— 251		+ 163	— 821
1974	3.884	3.884	—	+ 485	— 289	+ 50	+ 23	+ 269
(1,000 Million Guilders)								
1975	11,5	11,5	—	— 0,2	— 0,1			— 0,3
1976	10,4	10,4	—	— 0,7	+ 0,5	+ 0,2		—

Source: Column 1, 2, and 3 *Netherlands Budget Memoranda*, Column 4, 5, 6, and 7 *Account figures 1962-1973*, *Provisional figures 1973-1976*.

Explanatory comments

- + means overspending or at least an increased claim on the budget margin.
 - means underspending or at least a decreased claim on the budget margin.

In column 4 + is an increase of expenditure
 - is a decrease of expenditure

In column 5 and 6 + is a decrease of revenues
 - is an increase of revenues

tions. Viewed in this light procedural rules were laid down to determine the level of public sector financing which was consistent with balance in the rest of the economy. The essential elements of the "new orthodoxy" in the Dutch approach lay in the move from short-run planning to medium-term planning of the budget, and in viewing budgetary balance in a growth context. Hence the SBM procedure rests on the fundamental assumption that there exists some full employment "structural" growth path which is exogenously given, although it is admitted that there may be some short-run deviations from this path. It is then argued that some prescribed level of public sector deficit is consistent with the balanced growth of real output of the economy. Above this acceptable size of the budget deficit it is required that there should be a balancing of increases in expenditures with increases in taxes and non-tax revenues to maintain a deficit which will be consistent with the full employment level of total demand at the structural growth rate. As a by-product this budgetary rule stresses the weighing up of the increases in expenditures with increases in taxes, and thus emphasizes the conflict involved in providing for public as opposed to private needs. Alternatively using the Musgravian terminology, the "allocation" and "distribution" branches of the fiscal system constitute the structural aspects of budget planning, while the "stabilization" branch is allowed some flexibility for cyclical purposes. Thus discretion in budget planning is only to be allowed to operate on a cyclical margin. In this way an attempt is made to reconcile the secular (growth) with the short-run (cyclical) aspects of budgetary planning.

This distinction is not based solely on a difference in time dimension but also on a difference in policy objectives. The secular (automatic) adjustments of the budget aiming to adapt it to changes in the economy are distinguished from the short-run (discretionary) changes with quite opposite aims: to adjust the economy through the budget plan. The difference in emphasis reflects the belief that though deviations from the long-run structural growth rate can at least be partially corrected, the structural growth rate itself is insensitive to budgetary policy.¹⁸ First, there appears a certain lack of interdependence between budgetary policy and the long-run development of the economy in SBM theory. The application of the SBM procedure ensures a budget deficit that is consistent with structural values of private sector investment and savings as well as the foreign balance. However, each admissible use of the SBM, whether to increase spending or reduce taxation or both, may affect the conditions determining this structural equilibrium. Further, no distinction is made between the type of spending (e.g., whether capital or current), or between different taxes, which may also be considered to exert some influence on the private sector surplus and the future development of the economy. In practice, however, the Ministry of Finance admits a greater degree of interdependence and recognizes not only that different spending and taxing policies will affect the structural growth

rate but also that the structural growth rate and the progression factor of the tax system may be mutually determined.¹⁹ This is partly reflected in the frequent revisions made to the magnitude of these crucial parameters.

Embodied in this procedure of control, and from this presumption of a given equilibrium growth path, are derived three fundamental budgetary principles: structural constancy; marginal balancing; automatic cyclical stabilization. Structural constancy describes the thinking behind the concept of a natural or "structural" growth rate for the economy. This implies selecting an equilibrium base year when total aggregate demand and total aggregate supply balance at full (or high) employment. In equilibrium total output will equal total income:

$$GNP_0 = GNI_0$$

$$C_0 + I_0 + B_0 + G_0 = C_0 + S_0 + T_0$$

or $I_0 + B_0 + G_0 = S_0 + T_0$

where C = private consumption

I = private investment

B = foreign balance (hopefully positive)²⁰

G = all government expenditures

T = all government revenues

S = private saving

Given this equilibrium base year, a proportional growth path is hypothesized such that in each time period:

$$\Delta Y = \Delta C + \Delta I + \Delta B + \Delta G$$

Thus $\Delta(S - I - B) = \Delta(G - T)$

Private Sector = Public Sector

Surplus Savings Deficit

Hence the public sector's deficit is viewed as the balancing item in the economy as a whole, injecting that level of aggregate demand required to keep the economy expanding along its medium term growth path.

If the "acceptable" structural deficit is to fit in with private savings, private investment, deficits, or surpluses of the other public authorities and balance of payments situation, some constancy in the development of these quantities is desirable if they are to be structurally evaluated. As mentioned previously, in the longer run it is conceivable that there may be shifts in the structural parameters of the economy. Hence, there must be a continual appraisal of the development of the economy to try and separate deviations which are caused by structural changes and those merely caused by short-run cyclical factors. In practice, this involves consider-

able judgement. The composition of the deficit, it will be remembered, is also not felt to exert an influence on the structural constancy of private sector functions. Thus a specific use of the SBM is not considered to have more than a marginal effect on private sector functions and in this way constancy in equilibrium conditions for growth can be assumed. Furthermore, the basic presumption is that the structural trend in the economy is satisfactory, hence the public sector transactions can be viewed merely as a balancing item. Although this appears to have been the case in the 1960s, the evidence for the 1970s is less clear cut. Thus, in 1973 following the Oil Crisis, there was a reconsideration of the structural development of the economy and the size of the "acceptable" budget deficit was revised upwards. Over the period 1977–1980 additional budgetary measures, which will result in a purely temporary increase of the deficit, are taken to stimulate private investment, because the estimated level is not enough to guarantee the desired economic growth. Certainly, periods of prolonged disequilibrium create problems for the SBM policy by hiding the structural developments in the economy.

By accepting the structural constancy principle and the aim of a constant stimulus to demand from the public sector, then the *marginal balancing* principle follows. If the public deficit is to maintain a constant stimulus so as to ensure the economy remains on the hypothetical "structural" growth path, then it is argued that any expenditure above such a margin should be balanced by tax revenues. In this reasoning the balanced budget multiplier is ignored, or rather assigned a value of zero. On pragmatic grounds, however, its inclusion has been considered impracticable and doubts have been expressed whether the net results would be much altered. However, concentrating on a dynamic concept of budget balance ignores a considerable literature which has emphasized that although the deficit stays constant there is no guarantee that the demand stimulus will remain the same when the composition of the budget²¹ or the marginal rates of its components changes.²²

The final principle of the SBM, reliance on *automatic stabilization*,²³ derives from the basic assumption of a normal balanced full employment growth path and the aim of marginal balancing. This approach to stabilization has generally encountered two criticisms. First, some would claim that limiting the balance of government expenditures and receipts to some hypothetical standard growth rate irrespective of actual short-run conditions implies the private sector is to bear the brunt of any adaptation to short-run cyclical adjustments.²⁴ However, this is only the case if the alternative could have been a pure anti-cyclical policy. An a-cyclical as distinct from anti-cyclical policy is by its nature likely to have a stabilizing influence. Secondly, one can question the adequacy of automatic as opposed to discretionary stabilization. This is a continuing debate, the current consensus being that the two approaches are complementary. Automatic stabilization may help to main-

tain high employment levels and prevent autonomous disturbances from precipitating a major recession, but discretionary policy is needed to accelerate recovery from unemployment and give stimulus to the achievement of higher growth rates. While the Dutch would reject the usefulness of discretionary policy for the latter growth target, they have, of course, admitted the use of discretionary counter-cyclical policy into the SBM procedure by excluding such expenditures from the SBM test. As a result, in addition to the long-term SBM approach, the Ministry of Finance also carried out annual reviews of the short-run implications of the SBM rule. This so-called "impulse analysis"²⁵ has (until 1973) been presented along with the SBM analysis in the annual Budget Memorandum.

V. CONCLUSIONS

Are there any lessons to learn from the Dutch experiment with the new budgetary orthodoxy? It appears that operating the SBM since 1960 has not been without success, although any judgement cannot be conclusive without making some hypothetical comparison of how that experience would have differed had the SBM not existed. At the same time it could be argued that the difficulties encountered in SBM policy have arisen from a number of conflicting interests in the approach — conflicts which arise generally in budgetary policy but which appear particularly pronounced when adopting the "new orthodoxy".

The first conflict is that between the constitutional and economic aspects of the budget. Although based on a simple economic model the political nature of the SBM always remained near the surface. For instance, when introduced by Zijlstra it was used primarily as a means for reducing the tax burden and for holding down the increase in public spending. However, after 1965 when Socialists returned to the cabinet the emphasis was reversed. Greater stress was placed on increasing government expenditure and the SBM became a device to calculate the necessary tax increases. In the process the SBM concept itself suffered from political decisions. For example, the progressive increase in tax revenues was not compensated by reductions in tax rates. This meant in fact the acceptance of an increase in public spending greater than the structural growth rate in national income. As a result of such persistent adjustments and the increasing complexity of computation, it has sometimes been claimed that the disciplinary aspect of the SBM has been jeopardized. On the positive side, it must not be forgotten that despite certain crucial changes, the structural policy of the SBM has continued to provide the framework of budgetary analysis despite the varying political complexions of governments.

A second conflict arises between the long-term and the short-term needs of the budget. It has always been difficult to find a compromise between planning long-

term expenditures and taxes while allowing scope for short-run deviations for anti-cyclical purposes. Hence the criticism of the SBM procedure that constant price long-run projections of expenditure in a situation of inflation really side-steps the essential problem of short-run economic policy. The root of the problem lies in the difference in the type of fiscal regime required for secular as opposed to cyclical purposes. For cyclical purposes we would like built-in stability, for example, a system such: $G_I = gY_0$ and $T_I = T_0 + tY_0$ and where the marginal effective tax rate, $t > g$. However, in the face of secular growth in income such a system may generate a continuous rise in tax revenues proportional to expenditure and a tendency to surplus in the budget (i.e., "fiscal drag"). To solve this a continual revision of the tax code or a cut in tax rates, t , is needed. Apart from the considerable political and administrative difficulties, the result will be to sacrifice some of the built-in stability of the tax system. That the Dutch have found difficulty in sticking to their long-run priority is apparent from an examination of the fiscal analysis presented in the annual Budget Memorandum. There the centre of the stage is held by the SBM analysis but a "budget impulse analysis" is added, rather as an after-thought, serving as an indicator of fiscal impact in cyclical context. The latter analysis has been abandoned since 1973.

A third conflict arises between the rule and authority approach to budgetary strategy. That the Dutch practice has deviated from what they preach is largely the result of tension involved in adhering to the budget rule. Every control standard like the SBM must interfere with the full adjustment of policy to actual conditions, for, after all, the rationale of discipline and control is to tie the hands of the administration by narrowing their scope for discretionary action. Of course, the SBM has not been able to avoid the need for discretion: not only are discretionary expenditures for stabilization admitted, but discretion is also allowed in setting the parameters which define the margin. In this way the Dutch attempted to resolve the difficulty of how to graft active stabilization measures onto their structural approach (i.e., of how to deal with contingencies). In sum, the Dutch experience seems to lend support to Samuelson's dictum that rules are set up by discretion and abandoned by discretion.

NOTES

* Acknowledgement is made to the Social Science Research Council for a programme research grant in Public Sector Studies at the Department of Economics and the Institute of Social and Economic Research in the University of York. I would also like to thank Professor A. T. Peacock who read an earlier draft and Drs. A.J. Middelhoeck without whose help this paper could not have been completed. They, of course, bear no responsibility for the content and any remaining errors.

** The author is Assistant Professor of Economics, University of Singapore.

¹ A term recently employed by Professor Alan Peacock when describing contemporary developments in budgetary practice, c.f. Peacock [14].

² For a discussion of the concept and the problems of estimation, see Solomon [18] and Teeters [20].

³ The Plowden Committee Report [6] recommended the development of forward planning of aggregate public spending against a forecast of the probable growth of national income. For the development and adoption of the "productive potential" indicator for this purpose, see Godley and Shepard [5], Shepard [17], and the Seventh Report of the Expenditure Committee [7], (especially Appendix I, Annex 1).

⁴ C.f. Sachverständigenrat [16], and the discussion by Biehl *et al.* [1] and Lotz [9].

⁵ See de Wolff and Stevers [21].

⁶ For example, between 1961–1967 the underlying productivity growth was estimated between 2–2 1/2 %, and the increase in the labour force between 1 1/2–2 %. The result was an estimate of the structural growth rate for the economy of approximately 4 %. Optimism in the mid-1960s caused an upward revision in productivity estimates and the structural growth rate was increased in the late 1960s although subsequently revised downwards in recent years.

⁷ This description follows that contained in Stevers [19] and Burger [3].

⁸ A fuller description is contained in Burger [3].

⁹ The structural growth rates (annual averages) used for the purposes of SBM procedure are as follows:

1962–1965	4 %
1966	4.5 %
1967 t/m 1972	4.8 %
1973 t/m 1975	4.3 %
1976 t/m 1980	3.75 %

¹⁰ Frequent changes in base year are encountered:

	Base Year
1962 and 1963	: 1961
1964 and 1965	: 1964
1966	: 1965
1967–1971	: 1966
1972	: 1971
1973	: 1972
1974	: 1973
1975 and 1976	: 1974

¹¹ For example, the Central Government took over a greater share of expenditure from the municipalities as a result of the General (Special) Medical Expenses Act 1968, which involved a reduction in the share of the Municipalities Fund in total tax revenue. For other examples see Netherlands Budget Memorandum (abridged) [11, 1970, Appendix 2, Section D].

¹² Unemployment benefits which since 1968 were tested on a "structural" level, now again were tested with their real estimation.

¹³ This system of earmarking was not a binding one. For instance in any one year there was no guarantee that Compartment II would cover wage and salary increases, so that balancing was not carried out on an annual basis.

¹⁴ In any case, inflationary wage increases would produce additional tax revenue. In fact in previous years the inflationary increase in tax revenues has been virtually the same order of magnitude as the public sector's additional wage bill.

¹⁵ For a discussion of this point see Netherlands Budget Memorandum (abridged) [11, 1975, pp. 37–41].

¹⁶ All of which have changed periodically. Apart from the previously mentioned changes in base year and structural growth rate, the elasticity of the tax system has also been revised:

1961 – 1967	= 1.33
1968 – 1972	= 1.25
1973 – 1975	= 1.16

¹⁷ As Oort and de Man [13, p. 19], put it, "Structural budget policy must be comparatively simple to remain within the bounds of practical politics".

¹⁸ Some would argue that budgetary policy will have an effect on economic growth either at the micro, or "programme" level, (e.g., support for R & D, education, infrastructure, etc); or, at the macro level through the "purchasing-power effect". While the Dutch are partly willing to accept the latter effect due to its stabilizing influence on the private sector, the former effects are largely ignored. For them the crucial factors influencing the structural growth rate are the foreign balance and the private rate of saving rather than government policy.

¹⁹ C.f. Netherlands Budget Memorandum (abridged) [11, 1973, p. 28].

²⁰ The surplus on the current account of the balance of payments has a normative dimension. Policy is arrived at providing a surplus equal to the amount of official development transferred through the capital account.

²¹ This "weighting problem" has been discussed, among others, by Musgrave [10].

²² The problem of changing slope has been treated by Oakland [12] and Lotz [9].

²³ The built-in stabilization effect of the SBM procedure it will be remembered arises from the way government expenditures are determined by hypothetical rather than actual income levels.

²⁴ See the comments by Prest [15].

²⁵ For a description of this technique, see Burger [2] and Dixon [4]. The latter article also contains a comparison of the SBM and the impulse analyses and examines their relationship.

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Summary: *The New Orthodoxy in Budgetary Planning: A Critical Review of Dutch Experience.* — In recent years particular concern has been expressed over the inherent disadvantages of a policy of "fine-tuning" and many suspect that frequent variations in taxation and spending have not only been wasteful of resources but, due to time lags, destabilizing in their own right. Doubts have also been raised about the undue emphasis placed in economic policy on the functions of the budget as an economic regulator to the neglect of its more traditional functions as a mechanism for transferring resources from private to public uses. This paper attempts a review of the Netherlands Structural Budget Margin (SBM) policy which represents a pioneering attempt to harmonize the questions of allocation and stabilization by means of a simple budgetary guideline specifying the "desired" relationship between the growth in the public sector and the development of the economy as a whole. When examining the evolution of the SBM methodology it is evident the rather simple rule has been complicated in several ways when put into practice. Partly this has resulted from the need to overcome several operational problems involved in defining crucial policy parameters and the relevant expenditures to be tested against the budgetary standard — problems aggravated by inflation. However, perhaps the major difficulties encountered with SBM policy have arisen from the inevitable conflicts inherent in this approach to budgetary policy, most particularly: long-term versus short-term requirements of economic policy; the rule versus the authority approach to budgetary strategy; and, the political versus the economic aspects of the budget.

Résumé: *La nouvelle orthodoxie de la planification budgétaire: Un examen critique de l'expérience néerlandaise.* — Ces dernières années, on s'est tout particulièrement intéressé aux

inconvénients inhérents à une politique de "fine-tuning". Nombreux sont ceux qui ont accusé les fréquentes variations d'impôts et de dépenses publiques, non seulement de gaspillage des ressources, mais encore d'une action proprement déstabilisatrice, par suite des délais. On a aussi élevé des doutes sur l'importance excessive portée en politique économique à l'utilisation du budget en tant que régulateur de la conjoncture, au point de négliger ses fonctions plus traditionnelles, comme le mécanisme de transfert des ressources des fins privées à des fins publiques. Cette étude s'attache à examiner la politique de "marge budgétaire structurelle" ("Structural Budget Margin" — SBM) aux Pays-Bas, tentative d'avant-garde pour harmoniser les problèmes d'allocation et de stabilisation au moyen d'un critère budgétaire simple donnant la relation souhaitée entre la croissance du secteur public et le développement de l'ensemble de l'économie. Quand on examine l'évolution de la méthodologie de SBM, il est évident que cette règle, plutôt simple à l'origine, a dû être rendue plus complexe de différentes façons, quand il s'est agi de la mettre en pratique. Une des raisons en a été le besoin de surmonter plusieurs problèmes opérationnels, au moment de définir les paramètres principaux de politique économique et de tester les grandes catégories de dépenses publiques face aux standards budgétaires — problèmes encore aggravés par l'inflation. Toutefois, les principales difficultés de la politique de SBM tiennent sans doute aux inévitables conflits, inhérents à l'utilisation de l'instrument budgétaire, notamment: opposition entre les exigences du court et du long terme en matière de politique économique; entre "règle" et "autorité" dans la stratégie budgétaire; entre aspect économique et politique du budget.

Zusammenfassung: Neue Orthodoxie in der Haushaltsplanung: Eine kritische Bestandsaufnahme holländischer Erfahrungen. — In den vergangenen Jahren wurde besondere Besorgnis über die Nachteile zum Ausdruck gebracht, die der Politik der konjunkturpolitischen „Feinsteuerung“ inherent sind, und viele vermuten, daß häufige Veränderungen in der Besteuerung und den Ausgaben nicht nur zu einer Ressourcenverschwendung führten, sondern aufgrund von zeitlichen Verzögerungen destabilisierend wirkten. Zweifel wurden ebenfalls in bezug auf die Überbewertung geäußert, die in der Wirtschaftspolitik der Stabilisierungsfunktion des Budgets als einem wirtschaftlichen Regulator beigemessen werden und zwar auf Kosten seiner traditionelleren Funktionen, nämlich als Mechanismus für den Transfer von Ressourcen von privaten zu öffentlichen Zwecken. Der Artikel unterzieht die niederländische Politik des strukturellen Haushaltsdefizits ("Structural Budget Margin" — SBM), die einen ersten Versuch darstellt, Fragen der Allokation und Stabilisation mit Hilfe einer einfachen budgetären Richtgröße in Einklang zu bringen, wobei das „gewünschte“ Verhältnis zwischen dem Wachstum des öffentlichen Sektors und der Entwicklung der Gesamtwirtschaft spezifiziert wird, einer kritischen Überprüfung. Untersucht man die Entwicklung der SBM-Methode, so zeigt sich, daß die ziemlich einfache Regel, wenn in der Praxis angewendet, auf verschiedene Weise modifiziert und dadurch komplizierter wurde. Dies rührt teilweise von dem Erfordernis her, mit einigen operationalen Problemen fertig zu werden, die bei der Definition entscheidender politischer Parameter und revelanter Ausgaben, die im Verhältnis zum gewählten Budgetstandard überprüft werden, entstehen. Diese Probleme werden durch die Inflation noch verschärft. Jedoch haben die wichtigsten Schwierigkeiten, die im Zusammenhang mit der SBM-Politik auftreten, vielleicht ihre Ursache in den unvermeidbaren Konflikten, die diesem Ansatz der Budgetpolitik innewohnen; dazu zählen insbesondere: langfristige versus kurzfristige Anforderungen an die Wirtschaftspolitik; Regelbindung versus diskretionäre Entscheidungen und politische versus ökonomische Aspekte des Budgets.

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