Chapter 62

Fiscal Policy Effectiveness in the Tunisian Economy

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ABSTRACT

Based on Blanchard and Perotti, Perotti, and Biau and Girard approaches, this paper evaluates the fiscal policy's effectiveness in Tunisia using Structural VAR model. The results show the short-run macroeconomic efficiency of a structural increase in public spending in Tunisia with a fiscal multiplier close to 1,806, in line with Keynesian's models. However, the estimated effect of a structural increase in tax revenues on activity is non-Keynesian. This is explained by the presence of a voracity effect in the case of the Tunisian economy.

INTRODUCTION

In our days, we are witnessing a renewed interest in the usefulness of fiscal policy in order to combat economic cycle fluctuations, especially against its downward phases. In this way, it would be legitimate to question about measures effectiveness taken by governments in fiscal policy's terms. Are these discretionary measures able to stimulate economic activities or, on the contrary, are they harmful its? These fundamental questions were the subject of a debate and a vast literature that focused on the place of fiscal policy in economic cycle management. Several voices were raised again calling on governments to resort to an active fiscal policy. According to an interventionist approach of economy, public expenditures, transfers and taxes are able to maintain economic activity equilibrium. According to other approaches, these interventionist fiscal policy measures are inefficient and risk creating damaging distortions because they are taken at an unfavorable time.

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New approaches to fiscal policy can be summed up in two main streams, one of a classical nature and the other of a Keynesian nature. The "New Anti-Keynesian Theory of Public Finance" is taking hold in order to reinforce the ineffective fiscal policies' conception. This current tries to highlight the expansionist impact of any fiscal restriction, while the "New Keynesian Economy approach" (N.E.K) tries to highlight the importance of government intervention under certain conditions. The New Anti-Keynesian theory considers conventional approaches to fiscal adjustments to be ineffective. It assumes that a restrictive fiscal policy is more stringent and promotes economic activity's expansion. Developed by Hellwing & Neumann (1987) and Giavazzi & Pagano (1990), this current highlights the role of the reduction of budget deficit in the increase in production even in the short run, which represents a revolution against Keynesian usual analysis. According to this approach, economic theory distinguishes four essential transmission channels that are in favor of the effectiveness of fiscal restrictions in economic expansion. The first two channels are on demand side, the third channel is on the supply side, while the last is based on the public debt accumulation.

The New Keynesian Economics (N.K.E) argues the need for government intervention on the few issues basis, such as, market failures and poor coordination between them. Hence, the government intervention is important, in order to stabilize and regulate economy. Under hypothesis of non-neutrality of the currency resulting from prices and short-run wages nominal rigidities, and within rational expectations framework, analysis of New Keynesian Economy provides new foundations for the implementation of economic policies. Fisher (1977) assumes that economic policies are important and necessary insofar as they help to mitigate coordination failures between economic agents. According to Fisher (1977), government intervention allows the economy to, optimally, function. In the short run, and if economic activity is likely to deviate from its equilibrium state because of temporary and persistent shocks, a government intervention is able to correct this deviation and restore, once again, economic balance.

Some authors of this approach defend the discretionary nature of fiscal policy, such as Stiglitz (1993). Some others are incredulous about the usefulness of implementing fiscal policy, such as Mankiw (1993). He assumes that fiscal policy is unnecessary as an effective tool of smoothing out economic fluctuations. For him, government actions are usually counterproductive because its intervention is always late. Therefore, effective government action can take place during a severe economic depression. For the New Keynesian Economy (N.K.E), the existence of multiple equilibriums implies ambiguity in the use of economic policies. Hence, it's difficult to defend an active stabilization policy. This observation argues for the privilege given by certain authors of the (N.K.E) to implement monetary policy instead of fiscal policy, because monetary policy constitutes a flexible and elastic instrument and provides high monetary multipliers. Conversely, fiscal policy lacks flexibility and its fiscal multiplier is generally low. Also, this policy is characterized by public debt accumulation because it's always implemented for expansive purposes. This will have the impact of depressing the potential growth rate.

In the light of these different approaches' visions, the author will try to assess the effectiveness of fiscal policy implementation in Tunisian economic context, using structural VAR modeling. Thereby, this paper focuses on the role of fiscal policy in stimulating economic. The first objective is to understand how fiscal shocks are taken into account in main empirical approaches in order to assess the merits of structural VAR approach to which will used in the empirical investigation. The second objective is to identify transmission channels of fiscal shocks in order to analyze the fiscal policy effectiveness in Tunisia. In particular, the author proposes to measure the quantitative impact of public spending and tax revenue on Tunisian economic activity.

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