

COMMENT TO
“DOES FISCAL AUSTERITY AFFECT PUBLIC OPINION?”
BY ANNA KALBHENN AND LIVIO STRACCA

*Luiz de Mello**

1 Introduction

Public opinion attitudes towards changes in fiscal policy play an important role in the success of fiscal consolidation programmes. Concern among households and businesses about the adverse effects of fiscal austerity on activity tends to create negative confidence effects that weigh on the recovery over and above conventional Keynesian channels. These effects can nevertheless be offset, at least in part, by a confidence boost brought about by a commitment – followed by concrete action – by policymakers to redress fiscal imbalances that are deemed unsustainable. Motivated by the large medium-term budgetary consolidation needs of most advanced economies after the global crisis, a large literature has indeed emerged on the effects of fiscal policy on activity, including on the role played by confidence.¹

The paper by Anna Kalbhenn and Livio Stracca contributes to this literature by providing evidence on the causal links that may exist between fiscal consolidation, measured by outcome indicators such as the headline and cyclically adjusted budget balances, as well as the composition of adjustment between revenue and expenditure, and various public opinion indicators, including metrics for life satisfaction, consumer confidence and trust in national and European institutions. The authors focus on the experience of European countries during 1973-2013 and find that fiscal outcomes are in general poor predictors of public opinion, conditional on a standard set of controls. Somewhat stronger results are reported for attitudes regarding membership to the European Union and towards European institutions (Commission and ECB), although the sign and magnitude of the parameter estimates are not robust across model specifications.

2 Fiscal policy and public opinion: options for further work

Rather than dismissing the existence of public opinion effects of fiscal policy moves, the empirical literature would benefit from additional analysis on the possible reasons why the estimating strategy pursued by the authors may have failed to uncover stronger statistical linkages. Indeed, the charts presented in the paper show a clear uptick in the public opinion indicators after episodes of consolidation.

For example, could important information be lost in the data aggregation? While the macro variables are controlled for, attitudes vary considerably among individuals and households, whose characteristics are not taken into account in the analysis based on aggregate data. To be sure, it would be useful in future research to complement the analysis by evidence based on individual or household-level data.

It is also possible that failure to find a statistically significant effect of austerity on life satisfaction, consumer confidence and public opinion trust in institutions is due to reverse causality. The identification strategy pursued by the authors is based on the use of internal instruments, but

* Deputy Director, Public Governance and Territorial Development Directorate, OECD.

¹ See de Mello, L. (2013), “What Can Fiscal Policy Do in the Current Recession? A Review of Recent Literature and Policy Options”, *Hacienda Pública Española (Review of Public Economics)*, Vol. 204, pp. 113-39, for a recent review of the empirical evidence.

the lag structure of the relevant responses may be more complex than that envisaged by the authors. For example, are the results robust to a longer lag structure? Thus, it would be useful to gauge the validity of the instruments based on more complex lag distributions. Also, the complexity of the interrelations between fiscal policy moves and agent reactions requires additional work on the identification strategies and estimators that could be used to deal with reverse causality.

Another consideration is whether or not the indicators of fiscal austerity used in the empirical analysis are the most appropriate for gauging public opinion effects. It can be argued that *ex post* measures of budget outturns do not capture *ex ante* effects, which may be more relevant when assessing the impact of policies on perceptions and attitudes to policy more generally. In this regard, alternative metrics, such as fiscal shocks or policy announcements, could be experimented in future research.

Finally, the literature would benefit from further analysis on the choice of estimator and control variables to be included in the estimating equations. The presence of a truncated dependent variable would call for experimenting with probit, for example. As for additional controls, trust in institutions is known to depend on political attitudes of the electorate, which could be captured by indicators of the political orientation of governments. As mentioned above, the use of disaggregated data would allow for controlling for personal and household characteristics that are known to affect people's attitude to policy.

3 Conclusions

Evidence on the effects of policy on the public opinion is particularly important in the current juncture, when governments are struggling to regain the confidence of citizens in their ability to address the challenges posed by the global crisis. Fiscal policy is a case in point. However, whether initiatives to restore the sustainability of the public finances enhance or thwart confidence in government and institutions is a complex empirical question that will need to continue to be addressed in future research. To this end, a number of promising areas emerge, including not least the need to deal with agent heterogeneity, which calls for further analysis based on disaggregated data, as well as for more robust identification strategies to address reverse causality, which goes beyond the use of internal instruments. Further work in this area will contribute to the literature that has been motivated by the crisis on the effectiveness of fiscal policy as a demand management tool and the role of confidence effects when assessing empirically the potency of fiscal multipliers.