COMMENT TO
"THE RESPONSE OF POLICYMAKERS TO NATIONAL AND EUROPEAN FISCAL RULES – THE CASE OF POLAND" BY TOMASZ JĘDRZEJOWICZ AND MARCIN KITALA

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I would like to begin by expressing my thanks to Banca d'Italia for inviting me to participate at the 16th Workshop on Public Finance. It is a great pleasure to act as a discussant for the paper prepared by Tomasz Jedrzejowicz and Marcin Kitala. I would like to point out that in between I have left the European Commission, therefore the views expressed here and in the presentation are my own views and do not reflect the views of the European Commission in any way.

At first, I would like to provide a brief overview on the outline of this discussion. In the first part I will summarize the key questions addressed in this the paper. In the second part I will discuss the key challenges the authors faced in course of their research. Afterwards I will make some general remarks on the paper and in the last part I will discuss some specific caveats and provide the authors some ideas which could be pave the way for future improvements of their paper.

In this paper the authors addressed three key questions: 1) What is the impact of national and European fiscal rules in Poland? 2) Is there any econometric evidence on the pro-cyclical nature of fiscal policy decisions in Poland? 3) What is the effect of parliamentary elections on policymakers' actions in Poland?

The authors concluded that 1) "Policymakers in Poland have responded quite consistently to incentives stemming from the national debt ceiling framework." They also found that the "European fiscal rules are insignificant as a determinant of fiscal policy actions taken in Poland." 2) "Fiscal policy decisions have tended to be pro-cyclical." This is "consistent with incentives arising from the debt ceiling framework, which tends to have a disciplining effect during economic slowdowns and not in 'good times'" 3) "The imminence of parliamentary elections has contributed to a loosening of fiscal policy, but this result was not significant."

The key challenges the authors faced were the following: The existing literature uses mostly the Cyclically Adjusted Primary Balance (CAPB) as dependent variable to measure the fiscal reaction. Unfortunately, this measure might be distorted by the effect of asset price changes on tax revenue. Another well know weakness of this approach arises from the fact that tax elasticities are not directly observable. Moreover, the CAPB is affected by temporary measures as, e.g., by one-off capital transfers. A further issue concerning the CAPB approach is that there might be a significant lag between the announcement of a fiscal measure, the legislation and the reaction of the CAPB to the fiscal measure.

An additional very challenging task was to overcome the difficulties arising from the small sample size. Poland joined the European Union in 2004 and is therefore subject to the rules of the Stability and Growth Pact only since that year. The sample comprises the period 2004:Q3-2012:Q4, which consists of 34 observations. The data was available only on a semi-annual basis, therefore it had to be interpolated. Despite of the fact that this approach might be econometrically inaccurate, it is a necessary tradeoff, to which point I will come following some general remarks on the paper.

In general, answering the key questions addressed in this paper by using a regression framework is a very challenging task, due to the low amount of observations. The paper provides

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though a novel and significant contribution to the existing literature as it constructs an alternative, bottom-up measure of fiscal effort which is superior to the widely spread CAPB approach. This alternative measure captures both non-discretionary and discretionary fiscal measures. A further strength of the methodology applied is that the econometric approach used (OLS) in this paper is very clear.

Coming to the caveats and the weaknesses of this paper I would like to remark that the explanatory power of the model presented in this paper is rather low, the (adjusted) R^2 is lower than 0.20. This might be attributable to the small sample size, however it is possible that some important explanatory variables are missing and correlated with the regressors resulting in biased estimates due to the omitted variable problem. Therefore, I would recommend to control for further variables in the regression in order to enhance the inference.

Although the availability of data for Poland is strongly limited, a further weakness of the model arises from using interpolated data, which translates into half of the data being artificially generated and may in the end lead to incorrect t-values. An additional point worth mentioning concerns the estimate of the impact of the debt level. It fails to be significant, although it is only a linear transformation of the distance from the 55 per cent debt ratio. This might be unclear to the uninformed reader and should be elaborated on. A fundamental assumption made by OLS is that the relation between the independent and the dependent variables is linear. This assumption might be violated by non linearities, as the incentives could increase exponentially when approaching the 55 per cent debt-to-GDP threshold. A further point regarding the data used in the regression refers to the reliability of forecasts as the model uses forecasted data. Finally, taking the averages of fiscal measures required under EDP recommendations distorts the picture. To illustrate this, an adjustment of the deficit by 3 per cent within 3 years is treated in the same way as an adjustment of 1 per cent within one year. The authors should address this issue.

As the key difficulty arises from the limited data set for Poland I would recommend to use panel data analysis as a promising framework has already been developed in this paper and the data is available for eight and possibly further three countries. Exploiting data availability of other countries will provide further insights into the data structure and will carry the advantage of avoiding the usage of artificially generated data. This approach will also provide the possibility for creating a control group and open up avenues for obtaining further cross country patterns. Therefore, conclusions for Poland and other countries should be drawn based on robust results obtained by using a panel data regression framework.