COMMENT TO "FISCAL CONSOLIDATION AND INEQUALITY IN ADVANCED ECONOMIES: HOW ROBUST IS THE LINK?" BY DAVIDE FURCERI, JOÃO TOVAR JALLES AND PRAKASH LOUNGANI

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The paper deals with a topical issue of distributional effects of fiscal consolidation. The objective of the paper is to test a nexus between fiscal consolidation and inequality in a group of 17 OECD economies during the period 1978-2009 employing two alternative measures of consolidation such as the Cyclically Adjusted Primary Balance (CAPB) and the narrative approach, several alternative measures of inequality, and distinguishing between expenditure-based and tax-based consolidations.

The main contributions of the paper are the following:

A robust result emerges: fiscal consolidations increase income inequality in the short and medium term. This link holds with respect to the alternative measures of fiscal consolidations – CAPB and the narrative approach by Devries *et al.* (2011) – as well as for the alternative inequality indicators such as the Gini coefficient for disposable income (taken from the alternative sources: the Standardized World Income Inequality Database, SWIID, and from the OECD database), the share of wage and profit in GDP (OECD) and the combined "all the Ginis" indicator (Milanovic, 2014).

Concerning tax- versus expenditure-based consolidations, some evidence is found for stronger effects of expenditure -based consolidations.

Regarding the link between fiscal expansion and consolidation (CAPB), fiscal expansion is found to lower inequality in the short run, although this is valid for two measures only (the Gini coefficient from the SWIID and "all Ginis" by Milanovic, 2014).

Overall, fiscal consolidations are found to be associated with raising income inequality (by about 0.2-1.0 per cent in the short- and medium-term).

My comments and suggestions are mainly aimed at making the paper more accessible to a general reader, who is not an expert on the topic studied.

A first suggestion would be to comment on a link between inequality and wealth (or on the underlying assumption) and elaborate on motivation, which is mainly explained in the concluding section.

A second suggestion would be to add a literature review section. In particular, it would be useful to discuss the existing methodological approaches on assessing a link between fiscal consolidation and inequality and explain why the method by Jorda (2005) is chosen in this paper. What are its pros and cons? What are other popular methodological approaches (e.g., those used in the cited studies)? Why the approach by Jorda (2005) is particularly useful?

Third, the authors might wish to discuss their choice of countries and mention the specific features of the OECD-17 group. It would be useful to provide some stylized facts, for example, correlation between wealth (income per capita) and inequality (the Gini coefficient) in the sample countries. Is there any link? To facilitate the interpretation of the results for a general reader, the authors could also comment on how big is a "0.2-1.0 per cent increase in Gini"? Is it perceivable in practical terms? It would be useful to provide some benchmark.

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Fourth, more details on the data and estimations could be provided. In particular, what are the time series properties of the data used in equation (1)? The assumption of a linear time trend is used. How is it valid during the crisis period? What is the degree of persistence of the dependent variable? ("the dependent variable is highly persistent"). It would be useful to provide numbers.

Relatedly, the authors could perform poolability tests, to assess whether 17 countries represent a homogenous group, and provide diagnostic tests for regressions. To ensure that the results of the study are not driven by country-specific outliers, it would be helpful to plot the estimation residuals.

Fifth, on the conceptual side, it could be discussed how to separate the effects of shocks and fiscal consolidations, in particular in small open economies. Some of these shocks (e.g. shocks to expenditures/taxes) are not are not always exogenous, but might represent a result of another factors (external shocks), eventually also a changing legislation. One practical way to address this issue would be to perform robustness check sto the sample composition (e.g. group countries by income and by the degree of openness) and time period (e.g., check how sensitive the results are to the inclusion of the recent crisis – the sample ends in 2009).

Finally, a reader might wonder if there is an answer to the call stated in the epigraph: "[we need] a fiscal policy that focuses not only on efficiency but also on equity, particular on fairness".

Are there examples of such fiscal policy, e.g. in some of the countries covered by the study?

REFERENCES

Devries, P., J. Guajardo, D. Leigh and A. Pescatori (2011), "A New Action-based Dataset of Fiscal Consolidation", International Monetary Fund, Working Paper, No. 11/128, Washington (D.C.).

Milanovic, B.L. (2014), "All the Ginis Dataset" (updated Oct. 2014), available at: http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22301380~menuPK:64214916~pagePK:64214825~piPK:64214943~theSitePK:469382,00.html