COMMENTS ON SESSION 4: THE ROLE OF INDICATORS IN FISCAL POLICY

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Comments on "Political Implications of Fiscal Performance in OECD Countries" by Adi Brender and Allan Drazen

Adi Brender and Allan Drazen question is an empirical one, and very relevant not only in what Economics is concerned, but also in political terms – how does deficit reduction affect a politician probability of being reelected? A good number of us, I believe, may well think that a politician has to be courageous in order to engage in a deficit reduction or fiscal consolidation program. But Adi and Allan have good news for them – they will be rewarded, not only by history, but also by the electorate, and not in the long run, but also in the short to medium term. As a matter of fact, politicians that have reduced the deficit are more easily reelected, according to the technically sound, even if a bit surprising, results presented in this most interesting paper.

Authors should be praised by their clarity, and they are really careful when presenting data sources, definitions and methods. They rely on probit regressions, which tell the researcher the basic message that the deficit significantly affects the probability of being reelected, and this when several controls are (rightly) introduced – like the business cycle, inflation or majority voting.

A potential cause of bias that occurred to me was the following: and what about politicians that give up about presenting again for an election? What about those that, considering everything lost, withdraw from the political scene? This is a possible source of bias if a good number of fiscal consolidation protagonists are among these "notional losers".

The authors offer some possible explanations for their results. Namely, that voters are "rational forward looking individuals who do not follow for 'fiscal illusions'". One could well go a step further. A pure Barro-Ricardian economist could even argue that, in fact, rational forward looking individuals do not really care about deficits, in so far as spending levels are sustainable and financed by present and future taxes. But, clearly, the voters (and the authors) have a model in mind where deficits make a difference – and we all now there are several reasons for departure from Ricardian equivalence.

An alternative explanation for voters to care about deficit reduction comes to my mind. Deficit diminution is only one of the things a successful politician does. It works a bit like a "competence signal". Voters may read more in a fiscal

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consolidation episode than the deficit value. For example, they can infer that public sector efficiency increased, so that their taxes are more effectively spent.

I suggest two possible extensions:

- the authors have examined total expense and total revenue, concluding that government size does not matter. But it could be that spending composition matters...
- as the deficit is not an exogenous variable completely controlled by the policy maker, it would be interesting to check whether results are robust to the consideration of a cyclically adjusted deficit measure.

Comments on "Fiscal Policy Indicators in A Rule-Based Framework: An Indian Experience" by Ranjit K. Pattnaik, Deepa S. Raj and Jai Chander

In India, there is a double objective for budgetary policy – by the end of March 2009, the revenue deficit should be null, and the fiscal deficit should not exceed 3 per cent of GDP. Note that the revenue deficit equals the difference between current expenditure and current revenue. The objective in India is therefore a version of the golden rule.

The Indian deficit has declined in recent times, and the authors are interested in disentangling government action influence from the general macroeconomic performance one. They apply methods close to Kremer *et al.* (see Session 1) and compute CABs for India from 1991-92 to 2005-06.

As widely discussed on Thursday in this workshop, there are different ways of measuring trend and cycle – some are purely statistical, others rely more on economics. Moreover, given the trend and the cycle, the methods may still differ in the way of computing the cyclical component of the budget.

The main conclusion is that government action, particularly in what concerns revenue, has been important in driving the deficit down (and not so much general macroeconomic performance). Even if this conclusion is warranted by careful calculations by the authors, it is, of course, dependent on the methods they rely upon. As there is a good number of competing alternatives, it would be interesting to test for robustness of this conclusion by comparing with results from other procedures.