COMMENTS ON SESSION 3
FISCAL POLICY AND BUDGETARY INSTITUTIONS

Álvaro Manuel Pina[*]

1 Comments on "Do Budget Institutions Matter? Fiscal Consolidation in the New EU Member States" by Carlos Mulas-Granados, Jorge Onrubia and Javier Salinas-Jiménez

The paper presented by Jorge Onrubia deals with a number of important fiscal policy issues in the 10 central and eastern European countries that joined the EU in 2004 and 2007. Starting with an analysis of fiscal consolidation episodes, the study then presents original, comprehensive indices of budgetary institutions for the countries concerned. Finally, the paper assesses the influence of institutions (proxied by these indices) on fiscal policy aggregates (total and primary budget balance), controlling for other potentially important policy determinants, such as cyclical conditions, subjection to Pre-Accession Economic Programmes and the degree of coordination between different levels of government. I will focus my comments on the indices themselves, as well as on the estimated fiscal reaction functions.

In recent years there have been several attempts to compile numerical indicators that summarize budgetary institutions in the new EU member states. The authors mention the indices proposed by Gleich and by Yläoutinen, and in future versions of their study might also wish to take into account work by Fabrizio and Mody (2006), who construct a fiscal institutions index for the same set of countries and analyse its impact on the primary balance. The existence of different indices begs the question of whether the ensuing results are essentially the same. Onrubia and co-authors take some steps in this direction by comparing the country rankings derived from four indices (Table 9 in the paper[1]), and broadly conclude that similarities outweigh divergences. Taking the analysis a bit further, I have computed Spearman rank correlation coefficients based on the same Table 9.

The results are striking insofar as one of the indices (Gleich's) is clearly at odds with the others. This suggests that there may be scope for a systematic comparison of different indices, as regards the institutional variables considered, the interpretation/codification of actual national arrangements, and the weighting schemes used (see Mangano, 1998, for a similar exercise applied to measures of central bank independence).

From the estimated fiscal reaction functions, the authors conclude that institutions matter for fiscal outcomes, and that the discretionary powers of the Finance Minister (FM) in the execution phase (and to some extent also in the design

---

[*] ISEG (School of Economics and Management)/Technical University of Lisbon and UECE (Research Unit on Complexity and Economics).

[1] Here and elsewhere, numbering refers to the version presented at the workshop.

Table 1

Rank Correlation Coefficients between Different Indices

	Index (1)	Index (2)	Gleich	Yläoutinen
Index (1)		0.92	–0.05	0.73
Index (2)			–0.09	0.88
Gleich				–0.23
Yläoutinen				

Source: Own calculations based on Table 9 of Mulas-Granados *et al.*

phase) are particularly important. However, this prominence of the FM seems to some extent contradictory with the fact that most countries in the sample (eight out of ten, according to note 15) are regarded as having adopted the "contract" form of fiscal governance, rather than the "delegation" form – an issue deserving further discussion.

The very high volatility of the underlying fiscal data, especially in the early years of the sample (see Table 2 for several examples), calls for prudence in the interpretation of results. Caution is also urged by the fact that some coefficients present the "wrong" sign with high statistical significance – for example, the index ROLFM (role played by the FM in the design phase) in the sub-period 1999-2004 (Table 14). Finally, there is scope for further sensitivity analysis: for instance, it would be interesting to include in the reaction function some commonly used regressors – such as the lagged debt-to-GDP ratio or election dummies – and check whether the main results still hold.

2 Comments on "Beyond the SGP – Features and Effects of EU National-level Fiscal Rules" by Joaquim Ayuso-i-Casals, Diana González Hernández, Laurent Moulin and Alessandro Turrini

This paper makes several valuable contributions to our understanding of numerical fiscal rules and how they influence budgetary policy. Drawing on a new comprehensive dataset of national-level numerical fiscal rules in 25 EU countries over the 1990-2005 period, the authors propose a number of time-varying indices summarizing the coverage, strength and expected stabilization properties of such rules. More specifically, the paper constructs

(i) a *Fiscal Rule Index* (FRI), which measures coverage (share of public finances governed by the rules) weighted by strength (assessed with reference to the rules' statutory basis, monitoring and enforcement provisions and media visibility); and

(ii) a *Fiscal Rule Cyclicality Index* (FRCI), quantifying coverage weighted by stabilization properties.

The several "components" of the FRI (coverage and strength, the latter subdivided into several items) are also available as autonomous indices. Finally, restricting the attention to expenditure rules, the paper constructs an *Expenditure Rule Index* (ERI) along the lines of the FRI.

Joaquim Ayuso and co-authors then proceed to use their set of indices in econometric analyses of what prompts the adoption of numerical rules and of their effects on fiscal discipline and cyclicality. Before discussing the ensuing results, I would like to underline that the preparation of the indices is in itself a major contribution of this paper to the empirical study of fiscal policy.

The paper finds that public finance crises do not particularly favour the introduction or strengthening of numerical rules (Section 3.5 and Table 3), echoing a similar conclusion in the contribution of Fabrizio and Mody to this conference (regarding the reform of budgetary institutions). Yet some other papers (e.g. the study prepared by Kumar, Leigh and Plekhanov – Session 2 of this conference) argue that bad initial fiscal conditions tend to stimulate consolidations. Putting both results together, it seems that consolidation episodes and the adoption of rules are not simultaneous, and it may be the case that the former generally leads the latter – a hypothesis the authors might wish to explore in the future.

Through the estimation of fiscal reaction functions, the authors conclude that numerical rules exert a disciplining impact on fiscal policy: higher values of the FRI are associated to an improvement in the cyclically-adjusted primary balance, and the ERI also seems to restrain, to some extent, primary expenditure (Table 5). Leaving aside the problem of rules being potentially endogenous (an issue dealt with in the paper presented by Xavier Debrun), the econometric results are somewhat fragile in what concerns which characteristics of the rule (*i.e.*, coverage and components of its overall "strength") matter the most for fiscal discipline: in Tables 6 and 7, the numerical and statistical differences between the coefficients of the several sub-indices are often marginal. Hence the authors' suggestion that enforcement mechanisms are particularly important (Section 4.3), though entirely plausible, has limited empirical support.

To further analyze this issue, one may take into account that the evidence reported in Section 4.1 and in Table 4 of the paper is compatible with the possibility that certain monitoring and enforcement mechanisms tend to "depreciate", losing effectiveness over time. If such an effect exists, then taking it on board when computing indices of strength could change, and possibly clarify, some of the paper's results.

My final remarks concern the impact of numerical rules on fiscal cyclicality. The paper presents in Table 8 some evidence that in countries with "stabilization-friendly" rules (such as expenditure ceilings defined in monetary units, either at current or at constant prices) fiscal policy responds to the output gap in an anti-cyclical way, whereas in countries with a priori pro-cyclical rules (such as

deficit or debt rules) the feedback on the output gap is rather muted. There being many different specifications that can be used to measure cyclicality (as shown in the study presented by Roberto Golinelli and Sandro Momigliano in this conference), the paper would benefit from some sensitivity analysis in this area.

However, it may be difficult to detect a "linear" relationship between higher values of the FRCI and a stronger anti-cyclical stance (e.g., running for the whole sample fiscal reaction functions and obtaining a positive coefficient for the FRCI interacted with the output gap). The reason is that the proposed FRCI implicitly assumes that the absence of rules is "neutral" in terms of the cyclical stance: if a country with no previous rules adopts a deficit or a debt rule, its FRCI worsens (*i.e.*, decreases). This may not be the case: if the absence of rules corresponds to a fragmented budgetary process, with unrestrained "voracity effects" (Tornell and Lane, 1999), then reinforcing fiscal discipline could actually alleviate pro-cyclicality – even if discipline is associated to "stabilization-harmful" deficit or debt rules.

REFERENCES

Fabrizio, S. and A. Mody (2006), "Can Budget Institutions Counteract Political Indiscipline?", *Economic Policy*, No. 48, October, pp. 689-739.

Mangano, G. (1998), "Measuring Central Bank Independence: A Tale of Subjectivity and of Its Consequences", *Oxford Economic Papers*, Vol. 50, No. 3, pp. 468-92.

Tornell, A. and P. Lane (1999), "The Voracity Effect", *American Economic Review*, No. 89, pp. 22-46.