Discussion of "Mechanisms for the Control of Fiscal Deficits"

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A great paper to discuss!

- Interesting political economy questions:
  - Why do politicians issue too much debt?
  - How can we prevent them?
- Insightful model: I learnt a lot!
- Polished paper: even a macro-illiterate like me can understand it!

The economic sector: the main ingredients

- Model of strategic use of debt
- 2 types of public goods x and y
- 2 periods
  - In $t = 1$, gvt decides how and how much to spend

  $\Rightarrow$ level of debt in $t = 2$
  - In $t = 2$, gvt repays debt and decides how to spend what is left
- 3 groups of voters:
  - X voters prefer public good x
  - Y voters prefer public good y
  - Swing voters: agree with X voters in $t = 1$ and with X or Y voters in $t = 2$
- Key question: when does the policy maker issue too much debt in $t = 1$?

The political sector: what would happen under direct democracy?

- Suppose decisions (how and how much to spend) are taken *directly by the voters*
  - MVT: swing voters would be pivotal in all decisions

  $\Rightarrow$ No dynamic inconsistency

  $\Rightarrow$ optimal use of debt
- Paper uses *indirect democracy* to get around the MVT
  - Voters elect parties, not policies

The political sector: what about electoral competition a la Downs?

- Suppose parties can make *credible electoral promises* (on how and how much to spend)
  - Office motivated parties would catter to the swing voters

  ⇒ Back to MVT: no dynamic inconsistency

  ⇒ optimal use of debt
- Paper uses *ex-post politics* to get around Downs
  - No comitment: parties cannot make electoral promise
- *Restricted entry*: swing voters have no political representation

  ⇒ The best they can do is elect party X in $t = 1$ and party Y in $t = 2$

  ⇒ dynamic inconsistency and excessive debt!

Comment 1: why this model of politics?

- The economics of the model is pretty clear (even for me!)
  - The model is fairly parsimonious
- The ingredients of the political sector are less transparent
  - Political parties, imperfect electoral competition, incomplete political representation, changing preferences....
  - Why do we need all this?
  - Why not build on the other existing models of strategic use of debt?
  - What is hidden under the rug?

Comment 2: relation with literature on strategic use of debt?

- Common idea: preferences of policy makers change across periods
  - $\longrightarrow$ Intertemporal inconsistency
  - $\longrightarrow$ Excessive debt issuance to constrain the next policy makers
- Mechanism for political change between periods differs across papers:
  - Persson and Persson 89: identity of policy maker changes randomly
  - Tabellini and Alesina 90: identity of median voters changes randomly
  - Battaglini and Coate 08: identity of agenda setter changes randomly

Comment 2: relation with literature on strategic use of debt?

- Existing papers use standard models of politics in each period
  - MVT, Baron and Ferejohn 89...
  - This paper uses a more baroque model of politics. Why?
- Novel question: can supermajority requirements for debt issuance be desirable?
  - Azzimonti, Battaglini and Coate (2015) also address this question. What is the original contribution?
  - Is it only the political process?
  - If so, why is this political process more suitable to address this question?

Comment 3: practical implications?

- This paper shows that supermajority requirements for fiscal spending can be desirable
  - Begs the question: under what circumstances?
- The main practical implications: desirability of supermajority requirement depend on:
  - number of swing voters
  - probability that they swing

  $\longrightarrow$ Features of the model that are hard to map to reality

  $\longrightarrow$ Practical implication for constitutional design?