



Fiscal Affairs Department

INDEPENDENT FISCAL COUNCILS & FISCAL POLITICS

Comments on Beetsma, Debrun, and Sloof (2016)

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Presentation Outline

- I. Under which conditions are IFCs created and what are their effects?
- II. Fiscal politics: Elections, Fragmentation and Ideology
- III. Some suggestions to complement Beetsma, Debrun and Sloof (2016)

I. When are IFCs created and what are their effects?

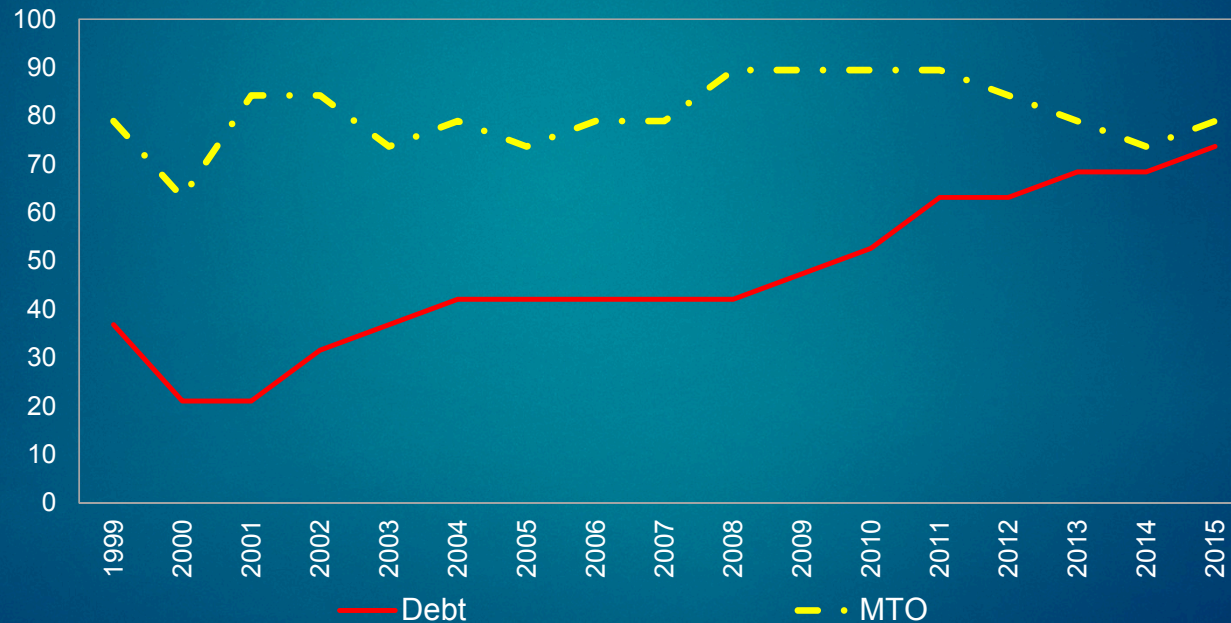
Beetsma et al (2016):

- ▶ IFCs have proliferated (more than 35 in 2015)
- ▶ Domestic political conditions should explain their emergence
- ▶ But pre/post averages of political indicators don't change around IFCs creation dates.
- ▶ The response to this puzzle?....a new theory of IFC creation and their effects –which shows that IFC's lead(*) to more fiscal discipline

I. When are IFCs created and what are their effects?

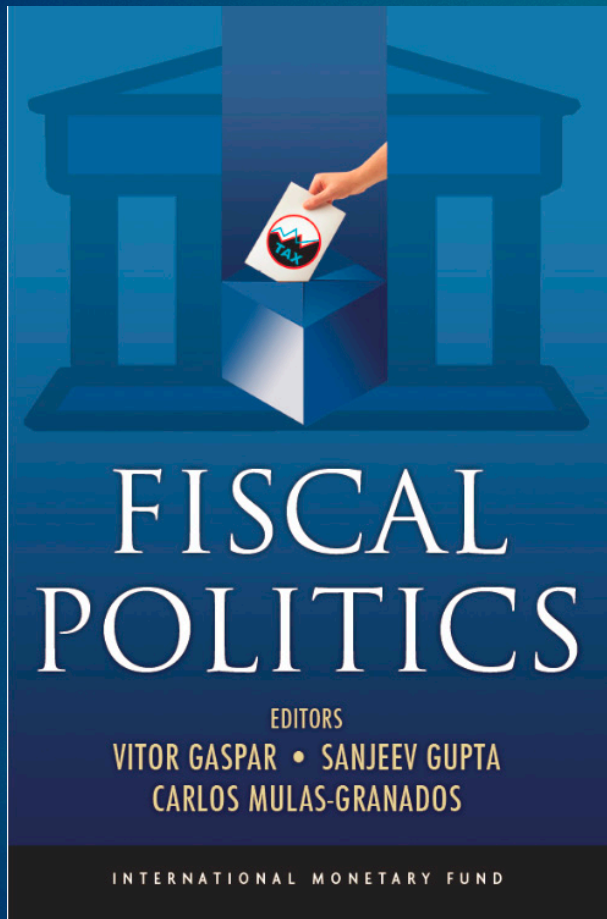
- ▶ But despite IFCs proliferation: weak fiscal compliance in Euro Area

Euro Area: Share of Non-Compliers
(1999=2015, EA-19)

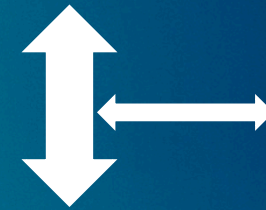


Source: IMF's "Fiscal Politics" (Chapter 18)

II. Fiscal politics: Elections, Fragmentation and Ideology



Fiscal Outcomes



IFCs and Rules

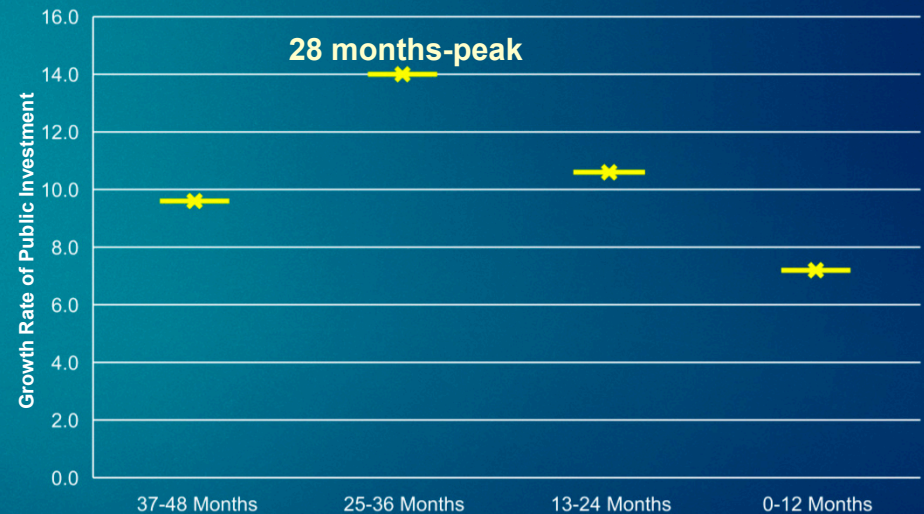
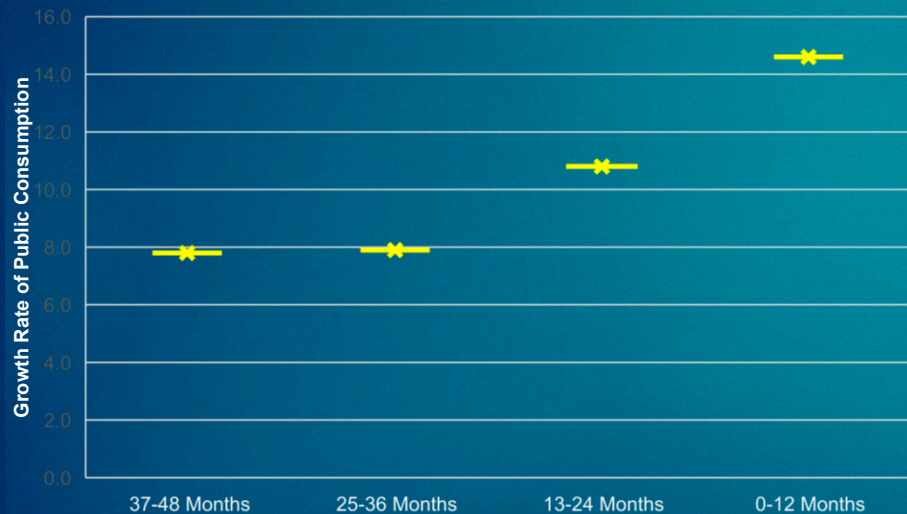
Political Factors

- *Elections*
- *Political Divisions*
- *Ideology*

II. Fiscal politics: Elections

On fiscal deficits: up to 1% of GDP higher deficits during election years, with pressure coming from the wage side, particularly in emerging and developing countries.

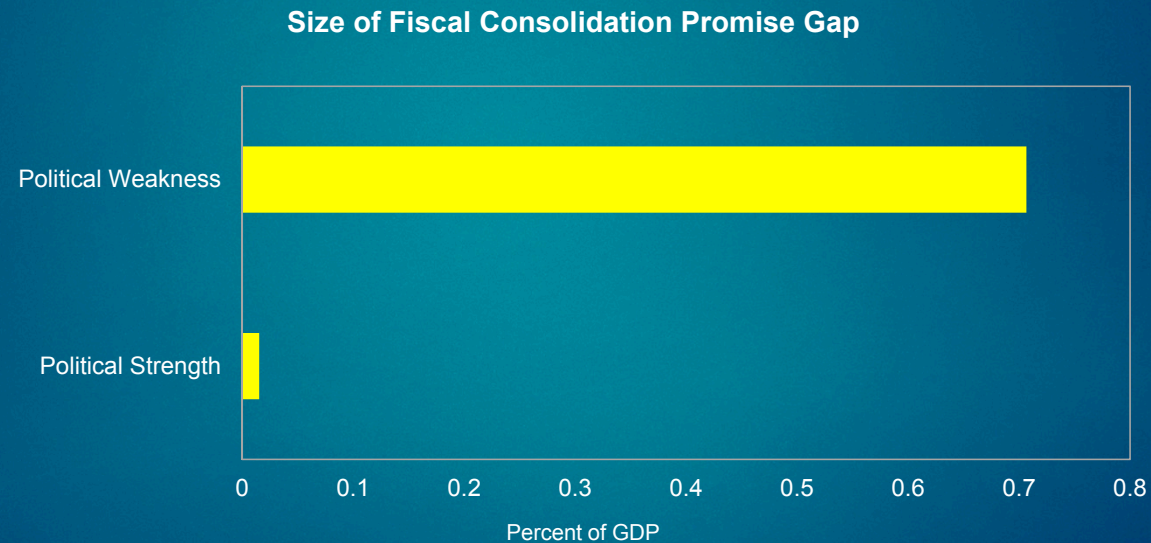
On budget's composition: consumption grows and investment declines as elections approach



Source: Gupta and others (2016)

II. Fiscal politics: Fragmentation

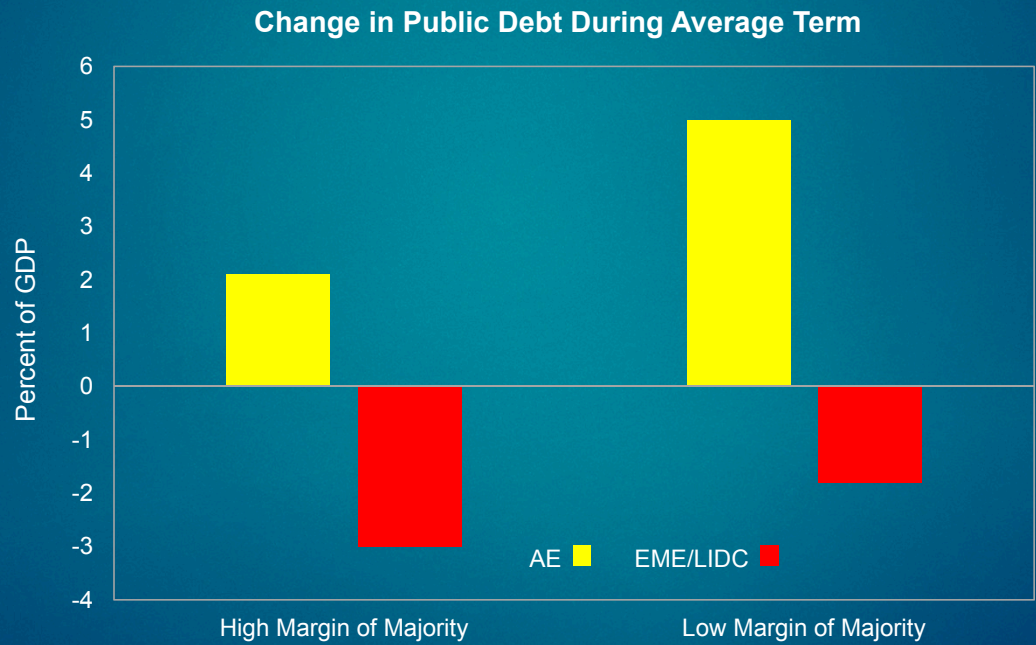
Political divisions are associated with large deviations between promised adjustment in fiscal deficit and actual outcome.



Source: Fiscal Politics, Chapter 2

II. Fiscal politics: Fragmentation

Weaker majorities are associated with larger debt accumulation in AEs and with smaller debt reduction in EME/LICDs, during the electoral cycle.



Source: Fiscal Politics, Chapter 9

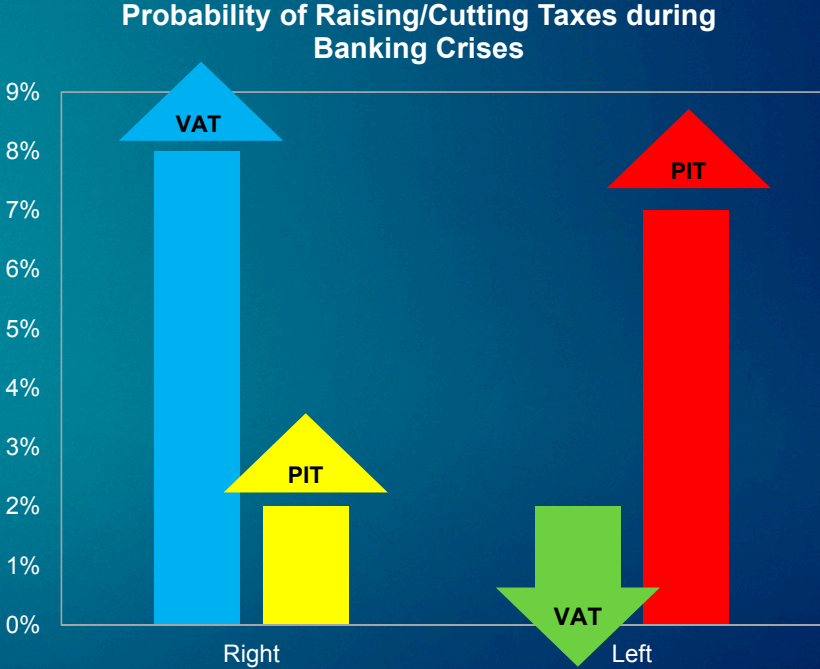


II. Fiscal politics: Ideology

IDEOLOGY AND TAXES:



Right governments are more likely to increase the VAT rates during crises, while left governments prefer to increase top-personal income taxes.

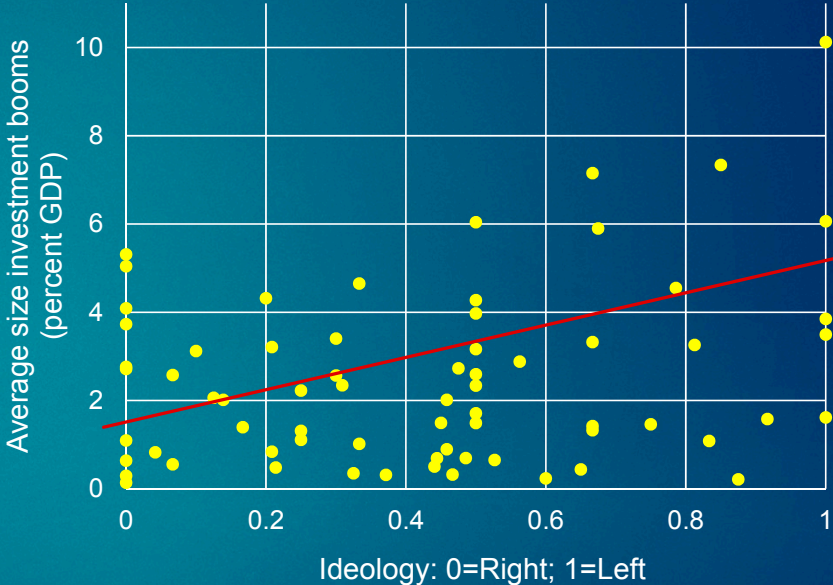


II. Fiscal politics: Ideology

IDEOLOGY AND SPENDING:



Left-wing governments are associated with larger public investment booms



Source: Gupta and others (2015) Now or Later? The Political Economy of Public Investment in Democracies, IMF Working Paper No.15/175

II. Fiscal politics: Main messages of the Book

- ▶ Politics has a decisive influence on fiscal policy formulation and performance.
- ▶ The impact of elections and political divisions is particularly significant.
- ▶ It seems that ideology has less of an impact.
- ▶ Budget institutions (e.g. IFCs) “only” help soften the effect of politics on fiscal policy.
- ▶ External constraints work if owned by country authorities.

(*) see appendix for empirical findings by chapter

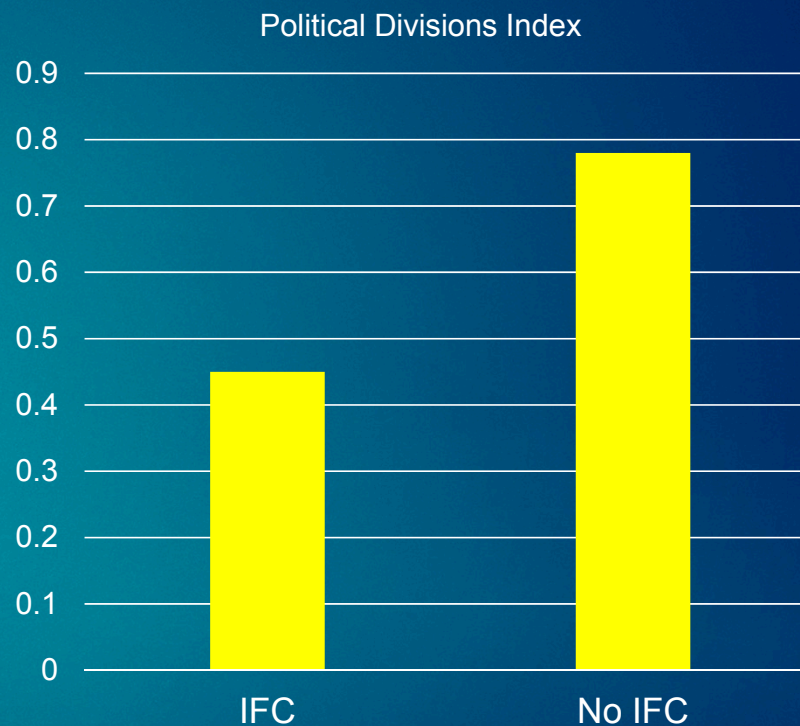
III. Suggestions for Beetsma, Debrun and Sloof (2016)

- ▶ Focus on the main theoretical finding: politics matter for both IFCs' birth and performance.
- ▶ Use concept groups: GROUP 1 COMPETENCE (short-termism; opportunism; partisan deficit bias); GROUP 2 CONGRUENCE (popularity, ideology, voter's taste)
- ▶ Focus on Incumbent's perspective: in real world IFCs are created by the executive branch.
- ▶ Summarize/concentrate on core findings

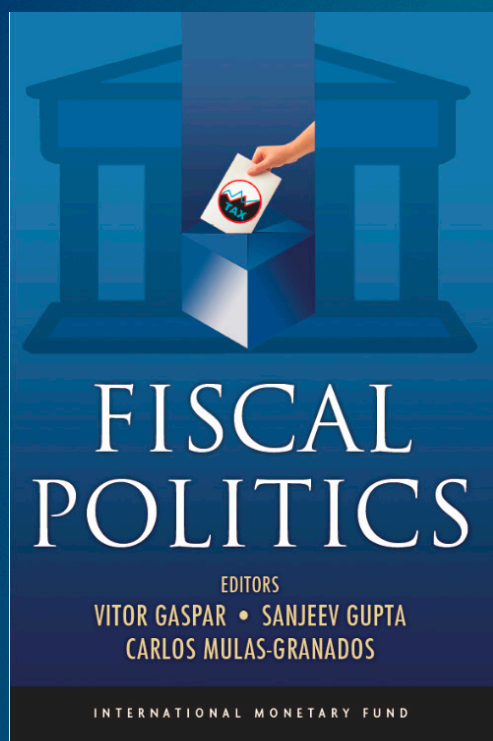
		Voters (value Congruence?)	
		NO	YES
Incumbent's Popularity (level of congruence?)	HIGH	IFC yes	IFC no
	LOW	IFC yes	IFC yes

III. Suggestions for Beetsma, Debrun and Sloof (2016)

- ▶ Provide some empirical evidence for the main propositions
 - ▶ Look for a proxy: if congruence matters = fragmentation and political divisions are high.
 - ▶ Show that high political divisions (i.e. congruence matters strongly) may be associated with the inexistence of IFCs.



THANK YOU FOR YOUR ATTENTION



“The essays in *Fiscal Politics* are gold mines...”
—Thomas J. Sargent Professor,
New York University and Nobel Laureate of Economics

“...will be of interest to both researchers and policy makers.”
—Timothy J. Besley Professor, London School of Economics

“A splendid and broad ranging contribution.”
—Alberto Alesina Professor, Harvard University

“They uncover new answers to a range of interesting questions...”
—Torsten Persson Professor,
Swedish Research Council and University of Stockholm

“This is a book that should be on the shelf of any policymaker...”
—Francesco Giavazzi, Professor, Bocconi University

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Annex: empirical findings for ELECTIONS

- During election years, countries register higher fiscal deficits by about 1 percentage points (Chapter 3)
- Spending on public wages increases by 0.2 percent of GDP during election years (Chapter 6)
- The growth rate of public investment peaks about 28 months before elections, and then declines about 0.7 percentage points as elections approach (Chapter 5)
- (Spain: The frequency of fiscally non-compliant regions is 1/3 higher during election years)

Annex: empirical findings for FRAGMENTATION

- Deficit reduction can be 7 times smaller in politically (weak) divided governments.
- Minority governments accumulate twice as much public debt during an average tenure than majority governments.
- Cabinets with lots of ministers accumulate 80% more public debt during an average tenure than small cabinets.
- Political fragmentation (measured by parliamentary control of the government) reduced the size of fiscal stimulus during the crisis by between 1 and 2.7 percent of GDP.
- (Spain: Regions ideologically aligned with the center presented greater fiscal compliance –frequency of cases is 14 percent higher)

Annex: empirical findings for IDEOLOGY

- No evidence that ideology affects debt or deficit levels, but ideology matters for the composition of taxes and spending.
- A right government is about 8 percentage points more likely to increase the VAT than a left government during crises
- A Left government is about 2 percentage points more likely to cut VAT in a crisis, and about 7 percentage points more likely to increase the top personal income tax rate.
- The average size of public investment booms by left-wing governments doubles the size of booms by right-wing governments (3.5% vs 1.75% of GDP)

Annex: empirical findings for RULES AND INSTITUTIONS

- Three years after the introduction of an Exp. Rule, the level of expenditure (and volatility) associated to electoral cycles declines by 4%.
- The seven countries with strongest fiscal councils had on average 2% of GDP better fiscal balances (2003-2014) than the rest of EU countries.
- Lack of ownership by national governments make supranational rules weak: For instance, the MTO was violated in 80 percent of observations between 1999 and 2015 in the Euro Area. In parallel, the share of countries with a debt ratio above 60 percent increased from 35 percent in 1999 to 75 percent in 2015, despite greater flexibility in SGP.