Opinion on Graves, 2007, A Coase-like Mechanim that Transfers Control of Government Spending Levels from Politicians to Voters.

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This is an interesting paper on the politically very pressing issue of how to bring fiscal indiscipline, which seems inherent to democracies, under control. The author focuses on the tendency of elected politicians to carry out excess spending, leading to excess growth in the size of the public sector, and proposes a mechanism for reducing excess spending growth which attacks the political distortion at its root.

The paper is well written and non technical, and clearly intended as an easily implementable policy proposal rather than as a theoretical exploration. However, I find that this is its weakness. I have a number of concerns regarding the practicality of the proposal which I list below:

- The main concern that I have is the following: The spending side of fiscal policy has many purposes, of which one is to respond to economic conditions in a countercyclical manor, and to act on opportunities to make beneficial reforms and investments which increase the long run growth potential of an economy. In all of these aspects, and in particular the former, the decision on what to spend on and how much depends on unforeseeable future economic circumstances. There are two solutions. Either we preclude government spending as a tool to reduce business cycle fluctuations and increase long run growth. This option is not desirable. Or there hence has to be some degree of flexibility in the interpretation of S. Such flexibility is very hard to design without leaving the door open for politicians to manipulate it through creative accounting, biased growth and interest rate forecasts, and so on. Graves lightly discusses this, but better arguments are needed to convince the reader that his proposal will solve the problem of all other types of numerically fixed ex ante and ex post budget rules.
- Along the same lines, the exceptions to M that could be enacted to address unexpected events (page and the suggestions to move around funds from different programs suggest high scope for politicians to use creative accounting to get around the S constraint if they so wish. This is an often stated reason for balanced budget rules to be less effective in keeping budget deficits under control, and it equally applies to M.
- A second concern that I have is that it political parties may and do also suffer from common pool problems internally. One candidate will be able to decide exceeding S, but this particular candidate will not personally bear the burden. She might even resign and leave the party before the burden is to be born. In other words, if the cost of exceeding S is not legally bound to the person making the decision, then the common pool problem is not internalized. The mechanism would have to rely on a strong sense of questionable party loyalty. Along the same lines, a party official might belong to other interest groups, and hence take

advantage of the party for paying for benefits accruing to these other interest groups.

- The suggestion that M would be even more effective in a coalition government (page 13) seems to contradict the common knowledge of the literature that coalition governments are more prone to excess spending and/or deficits due to common pool problems (see the von Hagen and coauthors literature). If coalition parties have different spending priorities, they will push for projects that exceed S since the cost of it will only be held by a fraction given by the number of parties in the coalition.
- A smaller point: The paper is in the tradition of Casella (2002) who suggests tradable deficit permits as a means to internalize the supposedly negative externalities of budget deficits within the European Union. The paper might benefit from a comparison.

Finally, it would be interesting to see a more concise or careful definition of the political distortion underlying the tendency toward excess spending would be nice, for knowing what the problem is that we want to solve. The literature is rather advanced on this topic (see surveys by Persson, Tabellini, Alesina and others) and the paper does not take advantage of this. It would be particularly interesting to see the mechanism M works in the presence of a pure common pool problem a la von Hagen and Harden (EER, 1996) or Velasco (1999), whether it would be different if we are talking about a time inconsistency of government preferences problem (Alesina and Tabelini, 1999), and if it holds water in all of these instances.