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Comment Paolo Pinotti

While the impact of fiscal policy on growth is a recurrent theme in the economics literature, the analysis of the opposite direction of causality, from growth to taxes, is much less developed. The chapter by Cahuc and Carcillo addresses exactly this issue, investigating the effect of output gaps on fiscal outcomes, as mediated by political and labor market institutions. To deal with the obvious reverse causality issues raised by such analysis, the authors exploit time variation in common business cycle components across countries.

The empirical findings suggest that positive output gaps increase the probability of fiscal drifts (simultaneous increases in the share of public wage bill and the public deficit over GDP) and reduce the probability of fiscal

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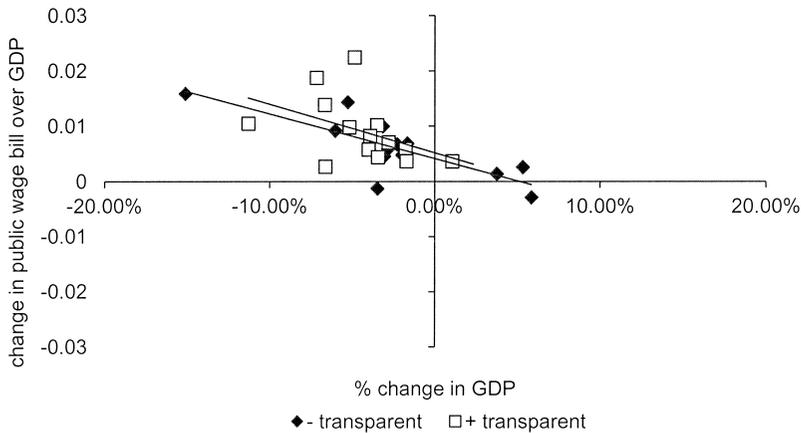


Fig. 9C.1 Change in the share of public wages over GDP, year 2009

Notes: This figure shows the change, between year 2008 and 2009, in the share of public wages over GDP in more and less transparent countries, defined as those above and below the median in terms of the ranking of Transparency International.

tightening episodes (the simultaneous decrease in public wages and deficits), both effects being greater in countries with less transparent government and more powerful labor unions. This result is extremely interesting, because higher welfare spending during economic downturns, as well as the existence of labor and fiscal rigidities, would in principle lead to countercyclical fiscal drifts. Their procyclicality may point thus at the importance of political economy drivers of public expenditure, as expansionary periods may relax the constraints of politicians and raise their incentives to engage in electoral spending.

As to negative output gaps, the authors claim that they do not find a significant effect on the probability of either drift or tightening episodes. However, the empirical evidence is not conclusive in this respect. In many tables, the effect of negative output gaps on (short) fiscal drifts is actually very similar to that of positive output gaps and close to being statistically significant (see, e.g., tables 9.4, 9.9, and 9.21). Moreover, the estimating equation is absorbing the effect of the last crisis in a dummy for the year 2009, which is associated with large fiscal drifts in almost all countries. Therefore, excluding such a dummy would increase the magnitude and statistical significance of the average effect of negative output gaps even more.

More generally, the coefficient for the year 2009 dummy is large and strongly statistically significant in most specifications. While the last crisis was indeed exceptional in many respects, this does not seem an adequate motive for partialing out its effect when estimating the coefficient of negative output gaps; for the very same reason, the year 2009 could be the single

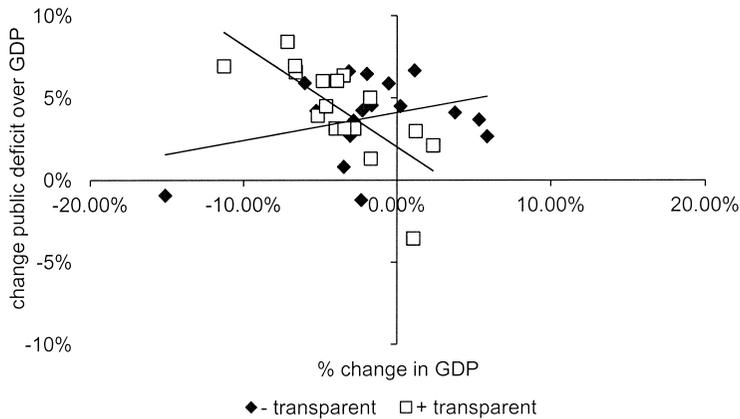


Fig. 9C.2 Change in the share of public deficits over GDP, year 2009

Notes: This figure shows the change, between year 2008 and 2009, in the share of public deficits over GDP in more and less transparent countries, defined as those above and below the median in terms of the ranking of Transparency International.

most important data point when estimating such a coefficient. This is even more true in light of the fact that the last crisis was essentially an exogenous shock for many countries.

Another issue concerns the construction of the dependent variables. Lumping together the dynamics of public wages and budgets provides an intuitive measure of “drift” and “tightening” episodes, yet it may hide differences in the dynamics of the two variables over the business cycle. Considering again the case of the last crisis, there appear to be significant differences in the change of wages and budgets across countries. In particular, the weight of public wages over GDP increased markedly both in more and less transparent countries (figure 9C.1), while public deficits were strongly countercyclical only in the latter group (figure 9C.2). Incidentally, these last findings point again at the informative power of the last crisis for understanding the impact of economic shocks on fiscal policy.