FISCAL RULE STRETCHING DURING FINANCIAL MARKET STRESS AND CRISIS

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ELECTIONS AND FISCAL POLICY

Considerable research has examined how [FILL IN]

FISCAL ACCOUNTING IN EUROPE

Stability and Growth Pact (SGP) sets deficit and debt levels.

· Before eurozone debt crisis, focus was on 3% deficit limit

Created an enforceable European government finance accounting regime, with **common rules** (European System of Accounts) and a **common accounting monitoring institution–Eurostat**.

Nonetheless member states have **first mover advantage**.

Debt and deficit figures are **first published by member states themselves**. They have first crack at **classifying a policy with seemingly ambiguous budgetary effects**.

Eurostat only **scrutinises and revises published figures post hoc**.

It is difficult within the European accounting regime to simply fabricate the government's fiscal position.

However …

FISCAL RULE STRETCHING

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· **voters don't really care** about revisions...

· so, governments have strong incentives to **rule stretch**.

Fiscal rule stretching: if the fiscal implications of a policy are potentially ambiguous, that a decision is made to minimise its debt and/or debt implications

ACCOUNTING POLICY RESPONSES TO FINANCIAL CRISES

HYPOTHESES

- H_1: Debt revisions will be smaller for years further from national government elections.

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- H_2: Debt revisions will be greater for years when there are endogenous elections.

- H_3: The effects predicted by H_1 and H_2 will be stronger when a country also has high financial market stress.

EMPIRICS: SETUP

Dependent variable: cumulative revisions made by **Eurostat** to government debt and deficit statistics (% of GDP) over the 3 years from initial publication. Revisions occur bi-annually (April & October).

Revisions to data for 2003-2013.

Cumulative **debt** revisions: [−1.1, 12.7]

Cumulative **deficit** revisions: [−4.5, 1.1]

Unit of analysis: Eurostat revision for a given year.

· There are typically 7 observations per publication year. The first in
  October of the publication year + twice a year for the subsequent 3.

Note: Revisions due to GDP revisions are **not included**.

- Years to election (Gandrud 2015)

- No election, Predetermined Election, Endogenous Election (Hallerberg and Wehner)

- FinStress (Gandrud & Hallerberg, in development)

Previously, most research on financial crisis used either Reinhart & Rogoff (2010) or Laeven & Valencia (2012). But,

· binary, no indication of intensity
· created post hoc, not real-time

Also:

· Years since publication
· Eurozone membership
· Exchange rate (vs. USD)
· Absolute gross debt & deficit levels (2015 vintage)
· Country varying intercepts

EMPIRICS: (PRELIMINARY) RESULTS

Figure: Marginal Effect of Election Timing (years to election) at Various Levels of Financial Market Stress on **Debt** Revisions
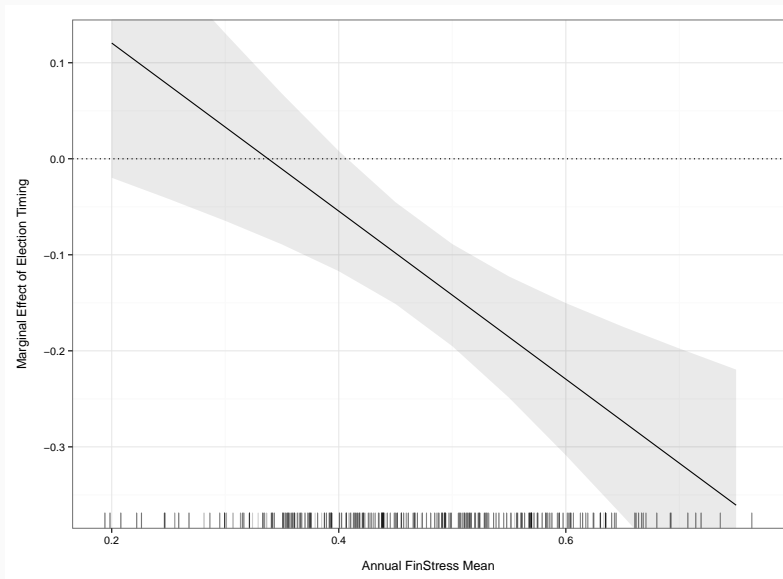
Figure: Marginal Effect of an Endogenous Election at Various Levels of Financial Market Stress on **Debt** Revisions
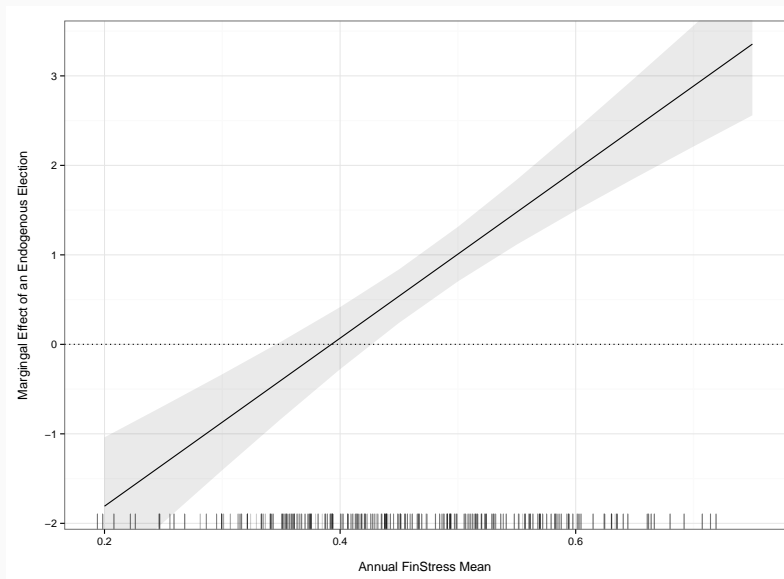
Figure: Predicted **Debt** Revisions in Four Years After Publication for Years with Different Election Types/Non-election Years
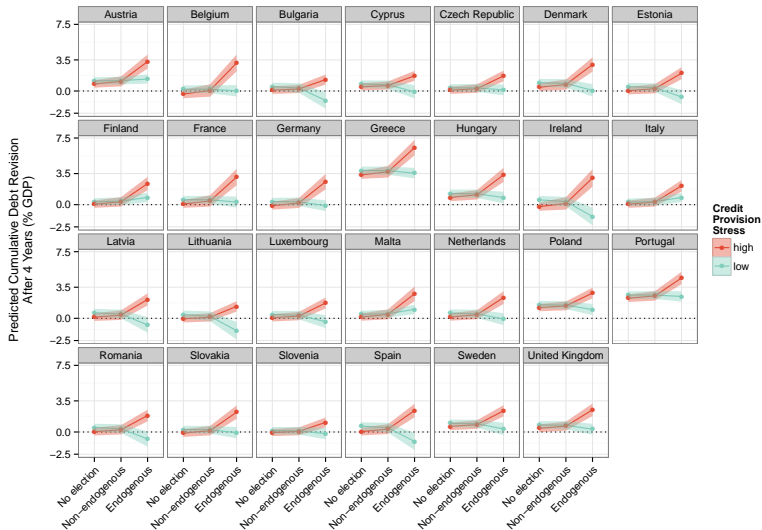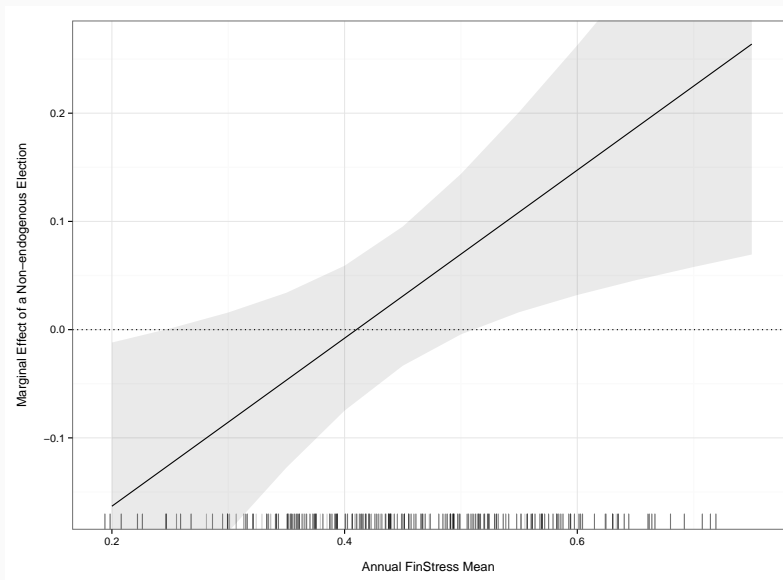
Figure: Marginal Effect of a Non-Endogenous Election at Various Levels of Financial Market Stress on **Deficit** Revisions

CONCLUSION/STILL TO DO

Omitted variables?:

· independence of national accounting agency.
· SGP enforcement actions (not just eurozone membership)
· Others?

Model choice: normal linear regression with many 0s?