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On the Drivers of Fiscal Consolidation Attempts –
A Bayesian Approach

A thesis presented in partial fulfilment of the requirements for the degree of Master of
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“The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed, lest Rome become bankrupt. People must again learn to work, instead of living on public assistance.”

Marcus Tullius Cicero¹

¹ Marcus Tullius Cicero was an orator, statesman, political theorist, lawyer and philosopher of Ancient Rome. He lived from about 106 BC to 43 BC. It is uncertain if he can actually be credited with this quote, or whether the quote was attributed to him in later writings. Nevertheless, it nicely describes the state of the Roman Empire at the time Marcus Tullius Cicero lived and the quote also seems to be a suitable summery of the very high government indebtedness of the present time.
In this paper we investigate which factors determine successful fiscal consolidation attempts. The literature on fiscal consolidation suggests a variety of fiscal, macroeconomic and political factors that are likely to influence the success rate of fiscal adjustment attempts. We focus on 31 of these aspects, as independent variables, and analyse their influence on a binary dependent success variable in a Bayesian model averaging framework for generalised linear models. The applied dataset includes 18 OECD countries and comprises the time period from 1975 to 2009. Bayesian model averaging estimates the generalised linear models with the highest posterior probabilities. By applying this method we can test for model uncertainty. As the posterior probabilities for the best models are, however, quite low we emphasise the posterior probabilities of the individual variables being included in the model. We find that the three variables that control for government social spending, the monetary stance and the formation of the government are highly likely to be included in the best model. Accordingly, a decrease in government social spending, an expansionary monetary policy and a unified government are supportive of successful budget consolidation. These results are mostly in line with findings in the previous research. Finally, several robustness checks confirm that the three variables have a high explanatory power for the dependent success variable.

Keywords: Fiscal Budget Deficit, Public Debt, Fiscal Consolidation, Model Uncertainty, Taxation, Public Expenditure, Bayesian Model Averaging (BMA), Generalised Linear Models

JEL Classification: B22, B30, C11, C23, E12, E13, E62, H12, H62, H63
# TABLE OF CONTENTS

ACKNOWLEDGMENTS ........................................................................................................ 1

ABSTRACT ........................................................................................................................ 4

TABLE OF CONTENTS ................................................................................................... 5

LIST OF TABLES ............................................................................................................... 7

LIST OF FIGURES .......................................................................................................... 8

1 Introduction ................................................................................................................... 9

1.1 Definitions ............................................................................................................... 12

1.1.1 Cyclically adjusted primary deficit ................................................................. 12

1.1.2 Attempts at, and success of, fiscal consolidation ............................................. 13

2 What the literature says about fiscal consolidation and its success factors .......... 17

2.1 Direct adjustments of the fiscal budget ................................................................. 17

2.1.1 Components of the fiscal budget .................................................................... 17

2.1.2 Success factors for fiscal budget adjustments ................................................. 18

2.2 Macroeconomic effects and fiscal consolidation ............................................... 20

2.2.1 Expansionary fiscal consolidations ................................................................. 20

2.2.2 Other macroeconomic factors accommodating fiscal consolidation ........... 21

2.3 Politics and fiscal adjustment .............................................................................. 23

2.3.1 Political consequences of fiscal adjustments ................................................... 24

2.3.2 Why are adjustments delayed? ....................................................................... 24

2.3.3 Fiscal rules and institutions .......................................................................... 26

3 Data and Methodology ............................................................................................... 29

3.1 Data ....................................................................................................................... 29

3.1.1 Dataset .......................................................................................................... 29

3.1.2 Dependent success variable ........................................................................... 30
LIST OF TABLES

Table 1: General government gross financial liabilities as percentage of GDP .......... 11
Table 2: Consolidation attempts loose criterion .......................................................... 31
Table 3: Successful consolidation attempts loose criterion ......................................... 32
Table 4: Consolidation attempts strict criterion .......................................................... 33
Table 5: Successful consolidation attempts strict criterion ......................................... 34
Table 6: Summary dependent variables ....................................................................... 34
Table 7: Independent fiscal variables .......................................................................... 36
Table 8: Independent macroeconomic variables .......................................................... 38
Table 9: Independent political variables ..................................................................... 39
Table 10: Summary statistics ....................................................................................... 42
Table 11: BMA results with dependent variable loose .................................................. 53
Table 12: BMA results with dependent variable loose and leading government wage consumption ................................................................................................................ 57
Table 13: BMA results with dependent variable strict criterion ................................... 60
Table 14: BMA results with only fiscal independent variables .................................... 62
Table 15: BMA results with only macroeconomic independent variables ................... 63
Table 16: BMA results with only political independent variables ............................... 64
Table 17: BMA results with dependent variable from Alesina and Ardagna (2010) ..... 67
Table 18: Consolidation attempts Alesina and Ardagna (2010) ................................... 78
Table 19: Successful consolidation attempts Alesina and Ardagna (2010) ................. 79
LIST OF FIGURES

Figure 1: The fiscal budget .................................................................18
Figure 2: BMA posterior distribution of the coefficients .........................73
Figure 3: Models Selected by BMA .......................................................77