THE POLITICAL COLOR OF FISCAL RESPONSIBILITY

Andreas Müller
University of Oslo

Kjetil Storesletten
University of Oslo

Fabrizio Zilibotti
University of Zurich

Abstract
We propose a dynamic general equilibrium model that yields testable implications about the fiscal policy run by governments of different political color. Successive generations of voters choose taxation, expenditure and government debt through repeated elections. Voters are heterogeneous by age and by the intensity of their preferences for public good provision. The political equilibrium switches stochastically between left- (pro-public goods) and right-leaning (pro-private consumption) governments. A shift to the left (right) is associated with a fall (increase) in government debt, an increase (fall) in taxation, and an increase (fall) in government expenditures. However, left-leaning governments engage in more debt accumulation during recessions. These predictions are shown to be consistent with the time-series evidence for the U.S. in the post-war period, and also with the evidence for a panel of OECD countries. (JEL: D72, E62, H41, H62, H63)

Keywords: Fiscal policy, Fiscal Responsibility, Government debt, Intergenerational conflict, Markov-perfect equilibrium, Political economy, Public good provision, Public finance, Repeated voting.

The editor in charge of this paper was Dirk Krueger.

Acknowledgments: We would like to thank Dirk Krueger, three anonymous referees, Zheng Michael Song and seminar participants at several institutions for very useful comments and discussions. The research leading to these results has received funding from the European Research Council advanced grant 324085 (under FP7/2007-2013). Kjetil Storesletten and Andreas Müller acknowledge support from the Norwegian Research Council through Oslo Fiscal Studies and ESOP. Sebastian Ottinger and You Wu provided excellent research assistance.

E-mail: andreas.mueller@econ.uio.no (Müller); kjetil.storesletten@econ.uio.no (Storesletten); fabrizio.zilibotti@econ.uzh.ch (Zilibotti)

Journal of the European Economic Association
Preprint prepared on 30 June 2015 using jeea.cls v1.0.