178.899 Master Thesis

On the Drivers of Fiscal Consolidation Attempts – A Bayesian Approach

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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 Cicero[1]

[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.

ABSTRACT

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

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