

Interesting idea: perhaps level of policy does not matter for growth once institutional variables included in the regression ...

... but volatility of policy does.

Very careful investigation

Estimating the effects of policy volatility on growth can be tricky

1) really one instrument here: oil price. Is this enough?

2) Always easy to argue that there is a “common underlying factor” causing everything...

.... but here there is a plausible story.

Suppose there is an underlying common cause of low growth and policy volatility: “**belief in government intervention**”, “dirigism”, etc.

Then a “dirigiste” government will also make sure to have **low checks and balances** on its operations => **undermines instrument**

Implications

Essentially, estimate parameter of fiscal rule:

$$G = \beta Y + \varepsilon$$

Find negative effects of volatility of fiscal policy residual, or fiscal policy “**noise**” σ_ε .

But does it imply that **reducing fiscal “activism” increases growth?**

Fiscal “activism” can take the form of **high β** (in absolute value) in fiscal policy reaction function.

A large negative **β** (strong countercyclical fiscal policy) may (or may not) be good for growth.

Aghion and Marinescu (2006): effects of **β** on growth (in OECD countries, argue that large negative **β** is good for growth)
This paper: effects of σ_ε on growth.

But one way to get low σ_ε is to constrain fiscal policy entirely, including reducing β (in absolute value)

=> important theoretical and empirical **question**: is there a **trade-off between output stabilization and fiscal policy noise**? If it exists, is there a clear prediction on which side of the trade-off developing countries should lean to?

Is there an implication for the design of fiscal rules? Suspicion that fiscal rules reduce β in absolute value; do they **also reduce σ_ε** ?

Presumably yes: if that's the case, is this positive effect on growth likely to **dominate the (possibly) negative effect from smaller β** ?