Efficiency of Flexible Budgetary Institutions

Bowen, Chen, Eraslan and Zapal

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Recap through *paper genesis*

- **Bowen, Chen and Eraslan (2014)**: discretionary vs mandatory spending (fixed preferences and private transfers): mandatory programs → higher public good spending.
- **Zapal (2011)**: Flexibility, i.e. explicit status-quo determination → (static) Pareto efficiency. Model with varying preferences and no private transfers.
- **This paper**: explicit status-quo bargaining idea into the BCE framework (with general varying preferences and no private transfers): flexibility can lead to dynamic Pareto efficiency.

Efficiency vs Equity

- Analysis focuses on efficiency, but equity is one of the very reasons why democracies provide checks and balances.
- Flexibility: breaks link between status-quo tomorrow and allocation today $\rightarrow$ more room of manouvre to proposer; responder power is the same (but he can still gain).
- Desirability of such institutions: potentially affected by e.g. social costs related to payoff variance or larger incentive to be the first proposer.
- However, main obstacle to equity is impossibility of committing before first agenda setter is drawn.

Constitution and Reform (1/2)

- Question related to equity concerns: would flexible budgetary institutions be chosen ex-ante? My intuition:
  - Always agreement on adding flexibility to fully mandatory institutions.
  - Possible disagreement on opposite reform (party A might veto when p_A is high).
- Reverse question: time-consistency of budgetary institutions.

Constitution and Reform (2/2)

- Historical question: can model explain development of institutions and weight shifting from discretionary to mandatory spending?
- Possible approach: consider what *founding fathers* mostly wanted to insure from (gridlock or political risk):
  - No turnover but preference variation $\rightarrow$ discretionary efficient
  - No preference variation but turnover $\rightarrow$ mandatory efficient

Debt and Mandatory Spending

- Varying budget size implicit in the model: what absorbes variations (e.g. private transfers or debt)?
- What is the relationship between debt and mandatory spending? Positive comovement from the data.

Other comments

- Stochastic preferences (more natural?): flexibility turns into state-contingency. Reminding of market completeness in finance.
- Varying majority requirements: e.g. discretionary spending not subject to unanimity (but bounded). Obamacare example.
- Possibility of transfer of power through p as well as through g? E.g. p higher if x closer to bliss point relative to other party.

Conclusion

- Very nice paper on important topic.
- Main comments:
  - Efficiency vs equity tradeoff: what is a good institution?
  - Institutional evolution and constitutional reform.
  - Relationship mandatory spending/debt.
  - Stochastic preferences with no commitment.

Thank you!