RESEARCH BRIEF • MARCH 2024

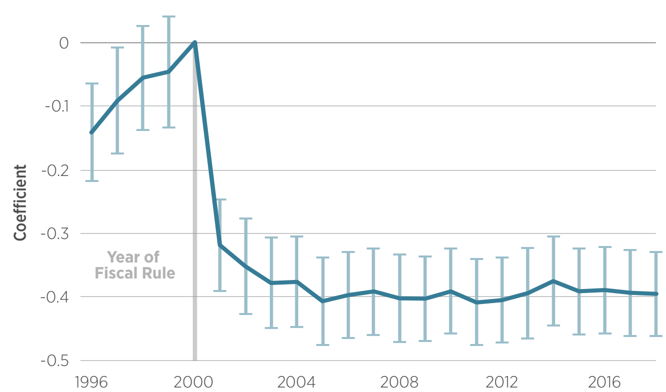
Fiscal Rules, Austerity in Public Administration, and Political Accountability: Evidence from a Natural Experiment in Colombia

Based on BFI Working Paper No. 2024-10, "Fiscal Rules, Austerity in Public Administration, and Political Accountability: Evidence from a Natural Experiment in Colombia," Maria Carreri, University of California, Berkeley; and Luis R. Martínez, University of Chicago

Limitations to fiscal spending in Colombia reduced overspending on public administration without affecting public goods, better aligning spending with voters' preferences.

A recent report from the Inter-American Development Bank on Latin America and the Caribbean estimates that waste in procurement, civil service, and targeted transfers amounted to 4.4% of GDP – an amount comparable to what countries in the region spend on education or health. **Fiscal rules** that set a numerical target for government spending offer a potential solution to this problem and are currently in use across both the developed and developing world. Their effectiveness, political feasibility, and downstream impact on public goods, however, remain unclear. In this paper, the authors examine the efficacy of fiscal rules at reducing spending, as well as their implications for living standards and politics.

Figure 1 · Impact of Fiscal Rule on Overspending



Note: This graph shows the impact of the new fiscal rule on overspending. The vertical lines show the 95% confidence intervals.

The authors study the introduction of a new fiscal rule across municipalities in Colombia. The fiscal rule, introduced in 2000, capped local governments' administrative operating expenditures at 80% of their revenue. In practice, the new rule only impacted those municipalities

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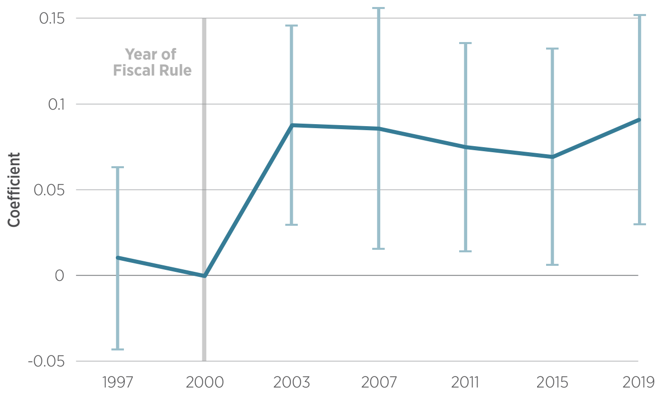
Fiscal rules: government-imposed restrictions on budgetary policies, typically aimed at limiting public debt, deficits, and expenditures

Figure 2 · Vote Share for the Incumbent Party



Note: This graph shows the impact of the new fiscal rule on the incumbent party's vote share in mayoral elections. The vertical lines show the 95% confidence intervals.

where operating expenditures were already above the legal limit when the reform was enacted. The authors take advantage of the variation in exposure to the rule across areas and compare municipalities that were more and less affected by the change over two decades. They explore outcomes along a range of dimensions, including fiscal variables, various measures of public goods and living standards, as well as electoral support for the local incumbent party and incidence of protests. They find the following:

- The fiscal rule was highly effective at reducing operating expenditures and the probability of deficits. Municipalities exposed to the reform experienced an average decrease of 32 percentage points in the share of their revenue devoted to operating expenditures, and their probability of a current deficit decreased by 31 percentage points.
- The fiscal rule did not lead to any meaningful change in local public goods or living standards. The authors find no change in measures of governance or local living conditions in affected municipalities after the reform. These include night-time luminosity as a broad measure of economic activity, measures of corruption, incidence of conflict, and multiple measures of health and education.
- The fiscal consolidation leads voters to be more satisfied with their local government and to re-elect the incumbent party at higher rates.

These findings provide new evidence on the effectiveness and sustainability of fiscal rules aimed at curbing wasteful administrative spending and provide valuable policy lessons for other settings in the developing world. Institutional arrangements like fiscal rules can help to align fiscal policy with the preferences of voters in settings where the electoral incentives for public officials are weak. Moreover, rules that target operating expenditures can help to improve the health of subnational public finances without compromising public good provision or causing a political backlash.

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NO. 2024-10 · DECEMBER 2023

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