ARE ‘DISTORTIONARY’ FISCAL POLICIES FISCAL FOLLY OR WELLBEING WISDOM? PERSONAL AND REGIONAL IMPACTS OF FISCAL POLICIES ON WELLBEING AND ECONOMIC GROWTH

ANNA ROBINSON

Arthur Grimes, Siu Yuat Wong

Governments tax and spend in order to improve the wellbeing of their citizens. We use cross-country, unit record data on subjective wellbeing to directly compare the growth and wellbeing effects of fiscal policies. Endogenous growth models predict that taxation and government spending can lower the long-run growth rate whilst increasing welfare - the policymaker’s ultimate aim. We extend Barro’s (1990) model to clarify the situations under which this divergence emerges. We test these predictions empirically using a large cross-country sample, spanning from 1970 to 2012. Our (general government) fiscal data are obtained from the IMF, whilst our unit record wellbeing data are derived primarily from the World Values Survey and European Values Study. We first estimate GDP growth regressions across an unrestricted and an OECD sample of countries, using a similar testing strategy to Bleaney et al (2001). We address endogeneity by instrumenting our fiscal variables. We separately test the effects of different areas of expenditure, and we test for interaction effects with inequality and measures of institutional quality. Previous studies on wellbeing and fiscal policy have focussed on overall government size, ignoring the type of taxation that finances government spending and how the money is actually spent. We apply our GDP growth regression methodology to the life satisfaction data, testing individual components of the government budget and making use of instrumental variables. Our unit record data enables us to test for differential wellbeing impacts of the fiscal variables based on personal characteristics.