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FISCAL POLITICS:
THE IMF EXPLORES ANOTHER SIDE OF PUBLIC FINANCE

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P R O C E E D I N G S

MR. DERVIŞ: Welcome everybody, and thanks for being with us. And a big thanks to Vito Gaspar and his team who prepared the book, and the panelists. I think it's a very, very important topic, and that the IMF is taking it on like this, head-on, is I think also a very, very good thing.

I'm not going to go into long presentations, but I am going to present all the panelists we have in one go, so that later on we don't get any interruptions.

Vitor Gaspar is director of the Fiscal Affairs Department; two seats behind him is Vito Tanzi the legendary, and I'm sure Vitor Gaspar is also going to become legendary. But then there is Teresa Ter-Minassian. So, you know, Fiscal Affairs is very well represented in this assembly. And it is one of the -- how shall I say? I can't say, you know, the best known, but one of the really path-breaking departments of the IMF.

Vitor Gaspar is director of the Fiscal Affairs Department, but he worked at Banco de Portugal. He was finance minister around 2011, at the peak of the crisis in Europe. And I think he has a lot to do with the fact that Portugal got put in the kind of, they are going to make it club, early on during the discussion. I don't know how much personal, you know, contribution he made to that, but I'm sure a lot, but Portugal actually, very quickly, was regarded well by the international financial and economic community, and I think Vitor has great credit for that. Before that he worked with the European Commission, and also with the European Central Bank.

The topic is fiscal politics, in general, but I'm sure that Europe will come up a lot. And let me jump over Carol, who is our own Carol; to Randall Henning, because he's coming out in two, three weeks with a book called "Tangled Governance: Regime Complexity, the Troika and the Euro Crisis." So, that title is pretty good; if you can get to the end, and read the whole thing and, you know, get it. But I think, I think fiscal policy during the Euro crisis is an excellent topic. And Randall is professor of international relations at the School of International Service at the American University.

Then we have our own Carol Graham, a senior fellow in our Global program, has been a senior fellow, director, all kinds of things at Brookings, and many, many incarnations. She is adored at Brookings, simply adored, for good reason, because she's a good great scholar, but also a great friend, a great team member, and never has failed to step in when somebody needed some help.

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And her latest is of course her book, "Happiness for All? Unequal Hopes and Lives in the Pursuit of the American Dream." It's, the American dream, it's based on a lot of American data, but it's a very global topic, and much of her presentations and other books and publications are global. She's also a Peruvian citizen, right, and likes that to be known. But I think she is, perhaps, one of the -- I would say the best-known academic economists who deals with issues of subjective satisfaction, happiness, interaction between economic and social demographic data, and how people actually perceive themselves.

And I think this is becoming a very, very important topic, because there seems to be the gap between what we see in the official data, or even the unofficial data, and how people seem to feel, or at least a good bunch of people seem to feel. So, Carol, your book will be a great success, is already a great success, but I think you are on the line which will become a major topic of discussion over the years.

Finally we have -- Not finally. We have Şebnem Kalemli-Özcan, who is the Neil Moskowitz professor endowed professor of economics at the University of Maryland, and a research fellow. She studies macroeconomics, finance, and growth and the inter-linkages. We were born in the same country, and she gives us the honor of coming quite often to Brookings, helping us discuss important topics in this domain.

Finally, there's Sanjeev Gupta, who is deputy director in the IMF Fiscal Affairs Department, and also served in the African and European Departments. He is prolific. I see him everywhere, as a blogger, or a writer, or article, or various things. I don't read everything but I see a lot. Congratulations on that. Before that he was a fellow of Kiel Institute of World Economics in Germany, a professor in India. And I think that may be the first time we met; the secretary of the Federation of Indian Chambers of Commerce and Industries. Or at least it was a time we met once also in Washington.

So the book, we will have a presentation by Sanjeev, of about 10-12 minutes, giving us the basic outline. Of course the book is large. It's not quite as long as Piketty or Gordon, but it comes close. And has many dimensions, but the focus of course is on the interaction between politics, and I should say, more electoral politics than non-electoral politics, because there is also, unfortunately, non-electoral politics.

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And the making of fiscal policy, the role of ideology, the role of pure party politics and electoral calculations, many, many of these factors are taken into account. I, myself, have quite a few questions, but I will reserve them till time for question and answer.

So, with that, I ask Sanjeev to come to the podium, and present it. And I think we had better stay seated -- or, wait a minute, have I got it wrong? We had better stay seated because there will be a --

SPEAKER: Yes, a PowerPoint, yes.

MR. DERVIŞ: Okay. And I will take Sanjeev's -- or next to Sanjeev's seat. (Applause)

MR. GUPTA: Thank you, Kemal, for a very generous introduction. And thank you, all, for coming. As Kemal said, my job is to really lay out the main features of the book in about 10 to 12 minutes.

Before I go there, probably there's a question which must be sitting in people's mind: Why did we do this? And when Vitor joined the Department some three years ago, we agreed that this was an area which we are not taught about. And we started some work which has now culminated into this book.

So, Carol had a different interpretation, and she will probably talk about it later. But I am going to leave that for the time being.

So, what I'm going to do is to focus on the presentation in terms of the book structure. So, first to talk about the motivation, and then look at the interface between fiscal policy and politics, through three channels: elections, ideology, and divisions. And from there I will go on to see whether fiscal rules and institutions are able to soften the impact of politics on fiscal policy.

And then I will turn to supranational fiscal politics, in the sense that if there any constraints imposed through supranational agencies, or arrangements such as Euro Area, does it make any difference to the fiscal outcomes? And then I will go on to the main policy messages.

So, the motivation very simply, is that the economics in politics, for us, at least this is one of the main conclusions of the book, are co-determined, especially when it comes to fiscal policy. And this is because state building and building tax capacity are fundamentally critical, and tax capacity is crucial when it comes to the smooth functioning or financing of governments' three core functions which, again, are inherently critical in nature.

For example allocation, the provision of public services is affected by different political constituencies: stabilization, the size, timing, and duration of both fiscal consolidations and expansions, are determined by proximity to elections. The redistribution function of the government whether it's left or right ideology has an implication on composition of taxes and spending.

So, in that sense there's three core functions are a factor with politics. So to sum it up, so the political factors that we are looking at are elections, political divisions, ideology, how they affect fiscal outcomes.

So, let me first start with fiscal deficits. First, I'll look at the impact of elections and their impact on fiscal deficits. What we find is that in the election years, overall deficits tend to 1 percentage point of GDP or higher, and the pressure for this higher spending comes from the wayside, and that happens particularly in the case of emerging and developing countries.

I can give some examples. We see that in case of Kenya, in the case of Moldova and Kosovo. The elections also seem to have an impact on budget composition, so what we find is that growth rate of public spending peaks about 28 months before elections. And thereafter it declines at the rate of 0.7 percentage points every month.

And so the peak is right at the -- it's not appearing but that's okay -- that the peak is right at the top, and so that's 28 months before the elections. And we find this to be the case in both advanced and in developing and margin-market countries. For example, we found the electorate's cycle in the (inaudible), investment in the case of Netherlands, in the case of Italy and Portugal. And then we found in the case of -- in developing countries, Honduras, Slovakia and a few other countries.

Then let now turn to the second impact of political divisions. Here, we define political divisions in terms of when there's thin majorities in the parliament, when the opposition is strong, when the cabinet is fragmented, and when that happens then the difference between what the governments promise in the form adjustment of fiscal deficit and actual outcome, those differences are much larger. And this is given by the top yellow bar, and the differences are 0.7 percent of GDP on average.

Then when the political strength is stronger in the counties, then the differences between the two variables that I talked about are minimal. That is the difference between what the governments promise by way of reduction in fiscal deficit and what they actually achieve is minimal.

Another example of the impact of political divisions, that happens when the countries which have high marginal majority, they accumulate less debt in the case of advanced economies, which is shown by the yellow bar on the left-hand side, they are the high majority. They accumulate less debt during average term compared to countries where they have a low margin of majority, so the increase in debt is larger during an average term in the case of advanced economies.

In the case of emerging market and low-income countries, the reduction in debt is lower in the similar kind of circumstances, and you can see on the left-hand side, the red bar shows the countries which have higher marginal majority, they are able to reduce debt more than their peers in the low margin of majority countries.

Now, finally, I turn to the impact of ideology. Interestingly we find that ideology doesn't seem to have an impact on deficit or debt. It seems it has an impact on the composition of taxes and spending.

I'm going to, for the purpose of brevity I'm going to focus just on taxes. So, one of the chapters here shows that right governments are more likely to increase VAT during crisis, which is shown by the blue bar, the increased VAT, there is a higher chance of increasing VAT, while the left governments prefer to increase top personal income taxes, which is shown by the red bar on the right-hand side. So, of course there are some examples that we have from the spending side, but I will skip those for the sake of time.

So, having talked about the three channels through which politics has an impact on fiscal outcomes, elections, divisions and ideology, then the issue that comes up, is to what extent fiscal rules and institutions can soften the impact on the economic outcomes.

And here, I will focus on the right bar, which is the experience with the expenditure rules, introduced during the electoral fiscal cycle, and what it shows is, the average of spending levels, which is given by the size of the bar, three years after the rules have been introduced. So, we find that the spending levels come down when the expenditure rules have been introduced, and the red dot gives the volatility in spending, and that also comes down.

So, what we see is that there is some evidence of rules being able to soften the impact, but not the entire impact. So, one should not make the leap that rules will take care of everything, but

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they do seem to have an impact in mitigating the impact of politics. Similarly when you look at the experience of fiscal councils, and there is a chapter in the book which looks at it, we find that they also help improve fiscal outcomes by communicating the rules more freely in the country.

Finally, I go to Supranational Fiscal Politics: and here what we find is the supranational rules such as under Euro Area are effective on their own by country authorities, and if they lack ownership then the compliance is not good.

And this slide here shows we have three particular rules, and we show the noncompliance of those rules in the Euro Area, from 1999 to 2015, the dotted zero yellow line gives the MTOD, medium-term objectives, that countries have themselves committed to adhere to. The red one gives the debt rule, and so compliance with the debt rule.

So, what one sees is that between 75 and 80 percent of the countries non-complied with these rules. The other line, which is the green dotted line, gives the overall deficit, of course that compliance seems to have improved since the crisis. And what is interesting is that noncompliance has remained despite the fact that the Euro Area introduced some reforms between 2005 and 2013.

So, this is my final slide, and so here we put as a contrast the experience with IMF programs, which seem to show some high degree of ownership. So, countries with the program conditionality in the revenue area, were successful in increasing public revenues. And so what this slide shows is, is the 45-degree -- countries which lie above the 45-degree line were able to increase their revenue one year after the conditionality was put in place, and that was the case in 75 percent of the country cases. And the yellow gives low-income countries, and the red gives middle-income countries.

So, the policy messages: politics has a decisive influence on fiscal policy from election and performance, the impact of elections and political divisions is critically important, it seems that ideology has less of an impact at least in the sample of studies that we have in the book, budget institutions can help soften the impact of politics on fiscal policy, and external constraints work if they are owned by country authorities. Thank you very much. (Applause)

MR. DERVIŞ: Okay. Sanjeev, thank you very much for this overview which, you know, one of the advantages, and one of the strengths, is that it's based on data, it's based on facts, on experience. Some of the results may not be too surprising because, you know, you would expect

pressure on wages before elections and so on, others are more surprising.

For example, one that is surprising is the fact that ideology doesn't seem to matter that much. So, while Sanjeev was that I was kind of thinking: well, why could that be? And I think two reasons came to mind. I mean, one is that in fact, ideology is more about composition than levels, perhaps, and this question I would like to ask whether there is some evidence on that. It may have been different in the distant past, but now it may be much more about levels to achieve a certain deficit or a certain fiscal policy.

The other more self-serving, not for me, but many center-left governments claim that they are able to negotiate deals with the unions and with the partners more efficiently than center-right governments, where center-right governments may be more committed to fiscal stability, so the two may be kind of cancelling out.

And I, myself, have had some experiences like that. You know, in politics it quite often happens that, you know, the Nixon to China syndrome; or the goal telling everybody that he had understood them, when everybody thought he was talking about French Algeria, and in fact he was mentioning, in his own mind, you know, he was already planning independence. So, things like that may also happen in fiscal politics.

But let me address the first question, or the first request for comments, to Carol Graham. Carol, what are your reactions to the presentation? And in particular, how does it fit some of your own work which is also highly political by definition?

MS. GRAHAM: Thank you, Kemal. And thank you, Sanjeev for a great presentation, and first of all, just to say this is a great effort, really comprehensive, and so nice to see the IMF taking this on in a big way, because it is so much the reality of whether policies get implemented or not. But my job is not to say a lot of nice things about the book only. Let me try and be a little bit provocative about, at least some things to be cautious about, because there's a lot of good, rational evidence.

But the big issue, of course, is how unpredictable politics is, and I think we are seeing that in spades right now. That in terms of not only what's happening in the U.S., and Brexit, and just a huge backlash in the rich countries against globalization, which is, you know, it seems perverse, but it is what it is. But what's equally important is that nobody predicted it. I mean most of us were really caught

by surprise.

So, here are my notes of caution, and the first is -- or both are actually kind of odd things to say to IMF which is always having to worry about crises, and fiscal deficits, and countries who are in bad shape economically; the first is, don't trust the numbers, the economic numbers, in terms of politics, so at least don't trust the averages.

Think about the standard deviations. Think about the winners and the losers. You can have a country that looks really good in terms of average, the U.S. did last year, and we were caught completely by surprise by the number of losers. Perceived or real, both saying goes with Brexit. I think if you look in the past it makes us look at the past a little differently, that's been the case in many other situations, but we need to look beyond the average economic numbers to understand what's going on.

And even, we need to look beyond metrics. And I hope this is going to be increasingly clear in the kind of globalized, high tech economy that we live in and everyone has to deal with. And I know, Kemal and I have talked a lot about this, in terms of the changing nature of the economy. What's the unemployment rate really telling us, when you have an Uber economy, and you have people, you know, just completely different work arrangements. So, we really need to look beyond the metrics that we are used to looking at because they seem to have a lot.

And then the other thing, again a little bit weird to say about IMF work, is beware of booms. When things are going really well, is often when you get the most frustration. China had it, then an open political society may not have survived entire growth period. It was a time that the same time that the economy was booming, life satisfaction decreased dramatically. Almost if you look at a chart that looks like this, and reported mental illness and suicides skyrocketed.

So, that seems perverse. But what was going on? There were winners, there were losers, there was a lot of change in the nature of the safety net. So, again, we need to look beyond the economic numbers if we are going to understand politics.

So, I think I've probably said enough with my time. The other thing, I agree with you, Kemal, on the ideology. I think you have overturned the sort of Nixon and China syndrome, the Alliance in Chile who were able to do more on the fiscal front because they are from the unexpected ideology, doing what they are trying to do.

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MR. DERVIŞ: But the opposition would be much greater if they were from the other side?

MS. GRAHAM: Right.

MR. DERVIŞ: Let me do a very quick survey of the panel, very quick. Central bank laws, there are various types, but in terms of the inflation target for those central banks who practice some form of inflation targeting. There are two choices, one is the central bank chooses the inflation target, and chooses the instruments with which it will pursue these targets. Or, the central bank does not choose, the government chooses with advice from the central bank, the inflation target, and in those cases where there is an unemployment target, maybe that too, of course; but let's focus on the inflation target.

And the central bank chooses freely the tools with which it tries to reach that target, and how it implements these tools. So, the first solution you remember and the second; is there anybody for the first solution from the panel?

MS. KALEMLI-ÖZCAN: Central banks choosing their target?

MR. DERVIŞ: Sorry? Choosing, yeah --

MS. KALEMLI-ÖZCAN: The central bank choosing the target, and then deciding the tools to use. I mean, that's, in general, the successive case in emerging markets, with the central bank independence.

MR. DERVIŞ: We had a big debate on this in Turkey.

MS. KALEMLI-ÖZCAN: Yes. But there's the exchange rate side. I mean, that's the big thing, I think, with this thing. I mean if you think it -- (crosstalk) depends on the exchange rate side --

MR. DERVIŞ: Well, I mean I think there isn't necessarily, no right or right.

MS. KALEMLI-ÖZCAN: Right.

MR. DERVIŞ: But in a sense the question poses -- or rather, illustrates what is the domain of politics versus what is the domain of economic management. Now, if a government wants to have an inflation target; for a while at least -- maybe even influenced by Olivier Blanchard -- of 3 percent rather than 2 percent. Okay? That's, I mean, for me that's a political choice. It's a democratic political choice. Then the central bank should implement that and should use freely, you know, whatever instruments it has, and whatever regime it is, implementing, and so on.

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To say that the central bank should actually choose the inflation target is a little bit more debatable, because at the end of the day the inflation target is an aggregate macroeconomic target, central bank is a non-elected, technocratic organization. So why should it be able to choose the target?

MR. HENNING: Kemal, may I?

MR. DERVIŞ: Yes.

MR. HENNING: So, I think your answer is wonderful. I'm wondering about your question. The reason I think your answer is wonderful is because, if I got you right, you are basically saying, look, the issue of the goals of the central bank is a fundamental political choice, and so one has to have debt done in a way which is politically legitimate.

In some places, you define the political objectives of the central bank, in a way which is reasonably vague, like you should pursue price stability and full employment; and have the dual mandate, and both goals are reasonably vague and they have to be made operational. Now, that is perfectly fine. It's a form of a delegation contract. What you cannot have is a central bank which is goal-independent, the mandate must be political, but the frontier of the mandate of politics has to be --

SPEAKER: External.

MR. HENNING: -- defined by political system itself; but if you want a good answer, we Alan Blinder there. (Laughter)

MR. DERVIŞ: I think that was an excellent answer, but let's listen to Alan's answer. We haven't opened to discussion yet, but Alan -- Would you like to say something, Alan, at this point, on this point?

MR. BLINDER: I think it would be (off mic).

MR. DERVIŞ: Well, I just brought this up, not necessarily in connection -- it's not fiscal policy first of all, although it's connected, but it is this tension that there is between democratic legitimacy and the experts; you know. And this tension has become a matter of discussion and of debate much more strongly over the last two, three years. In many political campaigns 10 years ago, 15 years ago, it was good to feel good experts. Now, it almost, you know, has become suspicious I mean.

SPEAKER: Absolutely

MR. DERVIŞ: And so there is something, there is a balance I think to be struck between,

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let's say, the kind of, in a not very professional way, but I mean, the balance between people who have studied things and kind of know what they are doing, you know, and the average citizen. And it doesn't necessarily follow that because somebody has credentials, that the average citizen will become very convinced, and that seems to have increased a lot.

MS. GRAHAM: Can I -- Oh, sorry.

MR. HENNING: Well, I was just to build on that, and there is tension between technical experts on the one hand, and citizens on the other, kind of plays itself out specifically in this realm of fiscal rules, right, at the heart of this book. In the sense that, in principle, right, we would want to have fiscal rules that are sophisticated and that work in a pro-cyclical way; but if we are going to do that, then you need to kind of develop a -- you have to have the technical infrastructure in the bureaucracy, a set of experts.

They are going to calculate the difference between the actual budget deficit and the structurally -- the cyclically adjusted budget deficit. And that requires placing a lot of trust in people that are going to do those calculations. Right? Because they are going to produce a result which the rest of the system, the government may have to undertake policy adjustments in order to meet. This may be politically challenging for them to do so.

So, a mechanism, kind of, that relies on this, is one that places a lot of trust in its experts and in its institutions. This is the sort of system that I prefer, but it's not always a system that we can sustain. And I suspect that this is one of the problems that the Euro Area confronts when thinking about the questions of, you know, designing these fiscal rules. But it's true for other countries as well, but especially acute, I think, now in the case of the Euro Area.

MR. DERVIŞ: Şebnem Kalemli, this or any other thoughts, first thoughts?

MS. KALEMLI-ÖZCAN: I just wanted to ask, since we start to talk about this. This is very important to understand that the way, advanced country's central banker like, you know, the United States, goes around thinking about these things, versus an emerging market central banker.

First of all, an advanced country's central banker, you know, their life is much easier than an emerging market central banker. In advanced countries, when you are in a recession, you know, you just -- you lower interest rates, and that's what it calls for, you look at output gap, you know, that's pretty

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much, you know, your inflation and unemployment, in a recession things go together.

An emerging market central banker, you know, there are going to be two conflicting objectives, right. In the organization you want to lower interest rate, but at the same time your currency is depreciating, that depreciation is going to call for higher interest rates.

So, in that sense, in emerging market context, in open emerging market, to capital flows, in the world of global finance, it becomes very hard to manage the monetary policy, which is your job as an emerging market central banker when, you know, the politics and the government tries to give part of that task to you, and then the other parts to keep himself.

So because, I mean, if you are managing the capital flow, and if you are, you know, somehow watching the exchange rate, and we know from pretty much all the emerging market central bankers they always say, there's one price you watch, and that's the exchange rate.

If you are in a situation like that then -- which is linked to the interest rate, and the inflation target of course, because interest rate is your tool for inflation target, it becomes very hard, I think, to live in that world. That's the inherent drama, so I just want to say that.

MR. DERVIŞ: Do you mean with the fixed exchange rate?

MS. KALEMLI-ÖZCAN: Both fixed and flexible, because as you know emerging markets always live in the world of fear of floating, although they say they float, they never fully float as the United States.

MR. DERVIŞ: There is the fear of float. But before I shut up, let me share the Turkish experience with the IMF.

MS. KALEMLI-ÖZCAN: Sure.

MR. DERVIŞ: Which, I think very interesting. Okay? Or first there were many Turkish experiences with the IMF, I don't know many --

MS. KALEMLI-ÖZCAN: (Laughter) which one then?

MR. DERVIŞ: But the one when I was in the government; one thing we had to agree on was the inflation target for 2002 for the post-crisis year. Okay? And the inflation in 2001, and I think my - they may have revised the numbers a little bit, but was close to about 68 percent. And the average inflation of Turkey had been, you know, varying between 30 and 50, and was defying all economic logic,

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because the economists kept telling, you know, that either the inflation will go up and become hyper-inflation, or you have a stabilization program, and it will fall.

But somehow have an inflation that floats around 30, 40, 50 percent is very unusual. Anyway, I don't want to go into that. And we had a real debate. And of course, as so often happens, our central bank, the Turkish Central Bank, mainly agreed with the IMF that the target should be very ambitious, but not to the extent that the IMF wanted it to be ambitious. We wanted an ambitious target, but not from 68 as a starting point in 2001.

But anyway, I won't go into the details, but at the end, the IMF said 20 percent is a good target, (inaudible) with a 20 percent target. We said 40 percent is a good target, that because from 68 to 40, we will make it. And I was very interested in making it. In other words, because I think all targets project the targets that are always being missed regularly.

And so making what you say is an important aspect of credibility. Anyway, we agreed in the end on 35, and the actual outcome was, was close to 30. But during that whole debate, it became clear that the target itself, was a government choice with advice from the Central Bank, in cooperation with the Central Bank, it was not a Central Bank choice, but a choice that was arrived at in conjunction with the Central Bank, but was a political choice by the Government.

And I personally believe that key choices, targets that whole of society like this, are not technocratic choices, they are democratic citizen choices, even if the information is often very imperfect. Then the instrument with which you pursue that should be entirely left in the hands of the central bankers, or finance ministry officials, and so on. And I was just wondering whether this basic principle, which I think the Fund agrees to, but in the -- 20, 30 years ago, I remember my Fund colleagues, you were far from there, you were nowhere near yet, were not so happy with that.

In other words, they had the feeling they themselves, knew so much more than the average citizen, particularly in a developing country, and in an emerging country, that they should have the leeway of trying to negotiate an inflation target, or an aggregate target. And I think this has not changed a lot where the democratic principles are -- It's the same as the wage target. I mean, how can you as a minister negotiate with the unions about wages in the public sector, if there is a letter of intent which sets a ceiling? I mean that makes a mockery of democratic unions and democratic politics.

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And thankfully, the IMF has gone away, and countries have gone away from side letters which were not published. Now things are accepted when the market is sensitive they are published. So, you know, you cannot have a public document which is at the same time subject to democratic negotiation.

And I think this is very, very important in the present phase to push back populist pressure, which will overshoot, and not to give the impression that there is a group of experts either international or national, that those things best -- if you like -- has the ability and the legitimacy to send targets which are essentially democratic targets in democratic countries which, of course, is yet another big debate. Okay.

MS. GRAHAM: Just on this?

MR. DERVIŞ: Yes, Carol.

MS. GRAHAM: Can I put my Peruvian hat on. I'm very much agreeing with your comments, which is, I totally agree, you can't just pretend politics aren't there, and it can't be externally imposed, but certainly in the case of Latin America, just giving a certain amount of independence and autonomy in the central banks, has been absolutely key to the years of the macro stability and prosperity that --

MR. DERVIŞ: Yeah. Absolutely.

MS. GRAHAM: -- that in the context of democracy, so it's sort of: don't throw the baby out with the bathwater. And that's a very nuanced point.

MR. DERVIŞ: Absolutely, absolutely. That, I fully agree. Anyway if --

MR. GASPAR: If you'll allow me to make a point of precision?

MR. DERVIŞ: Sure.

MR. GASPAR: Which I actually think is very important is the following. One of the quotes from political science that I like best is from Isaiah Berlin, who has shifted a quote from Kant, and the quote is, "From the crooked timber of mankind, nothing straight will ever be made."

What is he talking about? He is basically talking that in our interactions in society; we tend to put a tremendous amount of emphasis on our own interests, and if our fight for getting more of the cake is not constrained by rules, then everything gets crooked. And that speaks to the point that you

were making about the primacy of distribution.

Distribution is a fundamentally political problem. You could even say it's a central problem of politics. But Kant, when he was looking at these things, what he was basically saying, that in order to make this work in the best way for everybody, you need rules and laws.

And then John Rawls went one step further and said, "It's completely different to discuss actions in the context of the framework of laws and rules, and discuss the design of the framework, the rules and the laws."

Now, clearly what is regulated by law framework and rules is a political constitutional decision. But then, you may have decided that even your political system, it is best to delegate the target on an independent institution that will depend on the nature of your political system and your political constitution. Right? So, I was just avoiding to, I would say, oversimplify (crosstalk).

MR. DERVIŞ: Thank you very much. I think that the key is here, delegation. That you are doing this delegation in a legal way, in a democratic way, and you choose to do it.

MR. GASPAR: Absolutely.

MR. DERVIŞ: So, the stark contrast is not as stark. But, you know, to get debate going, and get excitement flowing a little bit, one has to sometimes put it in --

MR. GASPAR: But it can be constitutional, right? In some cases, you may think that the political problem that you are trying to control is so serious that you delegate at the constitutional level.

MR. DERVIŞ: Right.

MR. GASPAR: In some other cases, you may think that operational independence is enough.

MR. DERVIŞ: Right. Right. Okay. We'll open it a little bit to the floor but, you know, try to make it as interactive as possible. Vito?

MR. TANZI: Thank you very much. On the question of rules, you know, if you have a rule that some institution must be responsible for promoting that rule, and the institution to promote the rule must have an accelerator or a brake to move toward or away from whatever you want to achieve. But in many cases, the situation is so complex, that you don't know which is the accelerator and which is the brake.

Take the case of the 2 percent of the Central Bank, they've been trying desperately to get to the 2 percent for several years now, create trillions of dollars of assets, and we still are not there. So, we have to recognize that this idea that you just fix a rule and you have solved the problem, it's just unrealistic in many cases.

MR. DERVIŞ: George?

SPEAKER: Yes. A question on the work done by the authors; you mentioned the fact that the book relates mainly to democratic -- or at least electoral politics. There is of course the whole number of countries where politics is not highly democratic, in fact, quite authoritarian.

But nonetheless, let me give you a statement. Ken Rogoff postulated that fiscal policy is easy to explain within the U.S. or democratic countries, when one party comes in, they essentially reduce taxes on their constituents, and increase spending towards their constituents. And if you have alternating democratic system both parties, or whatever party is ruling, will end up with the same kind of levels of debt and deficit.

My question is, have you in the book or in the research found out that this is the case as compared, let's say, to a majoritarian party that rules for much longer and accumulates debt or deficits much higher, let's say, than an alternating democratic system? And, therefore, does it make any difference whether in fact the party stays in one place too long, or whether in fact it's an alternating system as to the outcome with respect to deficits and debt?

MR. GASPAR: It is complex. The two examples from the book, that I think speak more loudly to your question, are first of all, in democratic politics, when governments have large majorities, the gap between what they actually achieve and what they promise is very small. That was one of the slides that Sanjeev showed. While, if you have fragile governments, if you have a situation where the majority is tiny, where it's very difficult to mobilize the majority in parliament, in those cases the gap is much bigger. And that is something that speaks to your question.

The other aspect, which is also important, is that sometimes rules and institutions help, that is certainly the case when there is a strong ownership and in a sense oversimplifying, if the political system itself wants to be constrained. It is as if, if the political system sees a problem and tries to solve it in accordance the rules, rules operate as focal points and make it easier for the political system to deliver.

If on the contrary there is no ownership of the rules, then the political system, which is very creative, will find ways of circumventing the rules. But there are many other results that speak to your question in the book. I would definitely encourage you to read it.

MR. DERVIŞ: Jud?

SPEAKER: Yes. I'm Jud Schilling. I worked at the Bank for a long time, The World Bank, and with the IMF on occasion, and argued with them on occasion about these policies. So, I think that this is good progress to look more broadly at the fiscal politics. But I think it needs to go farther, to look at the sets of policies and the results that it will have on development, not just on reducing the budget deficit or meeting budgetary inflation targets over the longer term.

Because if they don't look at that, no policy is perfect, and just balancing the budget doesn't necessarily help growth or improve wages or things like that. I remember one discussion I had with them, an argument at length in Indonesia in '97-'98 after the financial crisis in Asia, where they were trying to cut the government expenditures and deficit, because that was their way of dealing with crises.

When the crisis there was not due to excessive government expenditure, but excessive financial sector lending and activities, like we experienced here a few years ago. And we had argued with them, if they cut back on government expenditures that would slow real growth and reduce the ability to have income to tax.

We finally, after a year, convinced them that they had to let the government continue beneficial infrastructure expenditure. So, I think that what is important to emphasize here, is not just the fact that there are politics involved, but look at the overall policy structure, over the medium term to see what policies are going to lead to more beneficial and sustainable growth.

MR. GASPAR: I would say, even in the long run, even in the long run. So, the book follows, to my mind, in my reading, and we say that in the introduction, follows two traditions that come from Schumpeter. One is what we have been debating up to now, and it has to do with the economic theory of democracy and Schumpeter pushed for that in capitalism, socialism and democracy.

But much earlier than that, in 1918, Schumpeter wrote about the crisis of the tax state. And what he was talking about is that politics are really at the roots of fiscal policy in general, and he took a very long-term, historical perspective. Although we don't have many papers with that perspective in the

book, I did contribute one myself, with Laura Jaramillo and Philippe Wingender.

And there, we look at tax capacity as an important element for the determination of state capacity, and following Besley and Persson, we show something which will come very intuitive to you, I believe, which is that all these indicators of state capacity, of quality of government provision of services, rule of law, protection of property rights, all of that; all those indicators are very much strongly, positively correlation.

And so indeed, not only does one have to follow the medium-term approach that you were talking about, one would be well advised to take a long-term view, and think about: what is the best way to enable state capacity? And that's a fundamental political challenge.

MR. DERVIŞ: Şebnem, on a more -- Do you want to add anything?

MS. KALEMLI-ÖZCAN: I just want to, because I didn't get a chance to -- You know, I want to say that I am actually very impressed by the book. And then given that I'm a little bit of an outsider to the whole fiscal policy picture. I think the book really did a great job in, you know, bringing this, exactly what Vitor said.

Like, you know, how institutions and politics interact, and the importance of deep, like historical political institutions in, you know, turning into politics, and in terms of like tax capacity and everything. And in fact that chapter has this amazing, you know, view of what Alexander Hamilton did, and how he insisted on paying the foreign debt fully, so that, you know, the United States gained credibility in the international market.

So you can keep borrowing there, while you structure the domestic debt which, of course, had a tremendous impact on the fiscal policy and politics afterwards; which is, again, you know, bringing me to my praise, that I think the book's focus on both these kinds of deep factors and the relationship to, you know, international governance and supranational institutions; and also bringing in evidence from emerging markets, and developing countries is very admirable because, in general, this literature is very much about advanced countries. So, I just want to add that.

MR. DERVIŞ: Anybody from the panel who wants to add something?

MR. HENNING: Well, let me just add the second -- the praise for the book, because I haven't had a chance to do that. I think this is really an impressive volume, okay, in terms of the reach

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and scope, but also the care, kind of, with which this research is carried out. And I appreciate the careful way in which the conclusion are stated, and the conditions under which the findings would be expected to apply, are stated as well.

It's audacious in calling it Fiscal Politics. It's a signal that the Fiscal Affairs Department is not going to be content with merely analyzing the economics, it is also going to make statements about the institutions and the rules, and the politics, and I think that's a good thing for the Fund to be doing.

I wanted to raise the point about the conclusions that we might be drawing from this book, for the organization of fiscal policy in the Euro Area. And I approach this, from the perspective of an American who's thought a little bit about the U.S. model, and I worry that Europeans draw the wrong lesson from the organization of the U.S. Federal system.

Sometimes they spend -- give undue weight, I think, to the balanced budget rules that apply to the states, and not enough weight to the no-bailout norm that applies in the United States, in combination with the strength and depth of the fiscal center that we have in the United States to provide countercyclical stabilization in a crisis. And in combination with these things, it's this context in which the rules operate, that they make the rules viable, not the other way around.

And so, I'm concerned that in the politics within Europe the rule, the definition of the rule, the strength of the rule is privileged, kind of relative to, kind of the development of these structures that make the rule viable. And this book does a good job stating at the outset, right, that the context is very important in these chapters that deal with the rules.

Where I might have a different preference than some of the authors in the book, although I think the authors, there's a range of views among the authors is: what do we do, yeah, what do we do in the case where the context that is the debt of the fiscal union, and fiscal integration, is not co-evolving with the rules? Do we double down on the rules, and strengthen them, or do we fall back on market discipline and reemphasize the no-bail-out clause that was originally embodied in the Maastricht Treaty? Or, in an amended sort of way that debates over that clause, but to reinforce the no-bail-out norm, such as it's applied in the United States for such a long time?

My preference is the second route, because I find that emphasizing these fiscal rules, takes you down a road where fiscal intervention would eventually be required by the center into states

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which are dysfunctional. And I think this fiscal intervention is so invasive of state sovereignty in the ultimate case, that this isn't sustainable in Europe.

So, my prescription for Europe is to follow the decentralized U.S. model, this is laid out so nicely in the chapters in this book, rather than this centralized model.

MR. DERVIŞ: Okay. Vitor?

MR. GASPAR: So, thanks for comments. One of my favorite papers, overall -- not from this book -- is the Nobel Lecture, by Tom Sargent. And I think that in the spirit of fiscal politics that's a truly wonderful lecture in which he argues that the crisis in public finance of many U.S. states in the 1840s. And the decision by the federal government not to bail out the states, which was something which was hotly debated here in the U.S., it was a political decision to do it in that way.

So, Tom Sargent argues in his Nobel Lecture, that that was fundamental for the political system in the U.S., and in particular for the political autonomy of the states in the United States. So, crucial for fiscal federalism which reinforces the point that Randy just made.

Now, in the book, there is a paper that I co-authored with Luc, who is sitting there on the second row; and Tigran who is sitting on the sixth row. And if you want to know the details, we can answer any questions that you possibly can throw at us. And what we show is that the degree of respect for the rules during the period 1999, 2015 was very weak.

That is something that we, as Editor, Carlos, Sanjeev and I, interpret as lack of ownership on the part of the member states of the European Union. And so in the book when -- in the chapter when we go to policy recommendations, we basically say that there are the two models that Randy was alluding to.

A centralized model that you apply, say, in Germany, or Brazil, where there is the possibility of intrusion by the federal government on state politics, and there is the decentralized model that applies in the United States, and it's first and foremost based on market discipline. We don't take a view concerning which system is superior, but we basically say, you should not be caught in the middle, you should make a choice, because if not, you are going to have something which is inconsistent, and inconsistent combinations don't work.

MR. DERVIŞ: I think that's a very important point, and it applies to other parts, I think

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financial systems, and so on, although there are always -- there are always exceptions, where are some special circumstances which, you know, necessitate a contradiction. Perhaps one thought -- Oh.

Teresa?

SPEAKER: First, a footnote on what Vitor said. I mean, the no bail-out clause in the U.S. has been in (inaudible) -- launched a series of bailouts in the United States, I think that it will be quite difficult to move one model to the (inaudible), takes time for credibility to be established. But my question was more a (inaudible). I mean I see that in the book, I mean from -- I haven't read the book, I (inaudible) to getting a copy soon, and reading it.

I see that you particularly focus a lot on the effect of one function of the government, the stabilization broadly defined. Have you look at also the impact of both ideology, and institutions on income distribution?

MR. GASPAR: So, in the book the issue of income distribution is not ignored, but it's not at the center of the research in the book. I was hoping that you were going to ask about other aspects of the government budget, because indeed we focus a lot on composition. Whether there is a bias against investment, whether there are compositional effects in the budget that are affected, including the composition of taxation.

There are comments on distribution effects that are linked to that, but when it comes to the issue of distribution, and I speak also to the point that Carol made right at the beginning; we have research and analytical agenda, which is autonomous and it's actually quite salient. Our fiscal monitor, this fall, will be dedicated solely to that topic. And although we do recognize the linkage with politics, we have a research agenda in that field, that actually was already in place at the time of veto, and then you continued, and so we are continuing on that tradition; it's more the political aspect which is more.

MR. DERVIŞ: May I add some -- I haven't read the book, I read the first chapter, and I know you deal with it, but I don't know how much you deal with it. But, do you know, there is somewhat simplistic formulation sometimes in people's minds, that says that you have to distinguish between investment and consumption, and if you think of a balance sheet, obviously if you invest in public assets, and they have a return, you may be strengthening the balance sheet of the public sector; whereas, if you spend it on pure consumption, you do the opposite.

MR. GASPAR: Absolutely.

MR. DERVIŞ: Okay. And this, in many ways, has been part of the European debate a lot. The problem is that it's not so simple to consider something in investment versus consumption. I mean, in some cases it may be clear, but capacity augmenting human capital, for example, which may be classified as consumption in some frameworks; it's often as important as building yet another school, or building, or so on.

So, in fact what seems conceptually, the correct and attractive distinction between investment and consumption, in practice becomes much harder to figure out although the conceptual correctness, I think, holds. Do you have any work in the book on that point?

MR. GASPAR: Yes. So, we look at issues like the quality and quantity of investment, and that depends on politics and institutions. It's one of those indicators that is most strongly correlated with other elements of state capacity. Although you are absolutely right that the issue of the border line between capital and consumption, is a hard one; it's still crucial. The main problem associated with saying that capital is good and consumption, one has to be careful, is that politicians faced by this classification, will start classifying as capital.

And so you need to have these things subject to reasonable criteria. And for that, you need strong rules, institutions and frameworks. And what we are pushing for in the Fiscal Affairs Department is for a comprehensive balance-sheet approach to general accounts, in which you can look at assets and liabilities, and then you can integrate the management of fiscal risks. But I do believe that you have been pushing for that yourself.

MR. DERVIŞ: Yes. That's correct. Okay. Any questions from the audience? Yes? We'll take a view, two or three and then --

SPEAKER: It's more of a comment, not a question. Going back to central banks just because I was at the Central Bank of Egypt for 11 years at very tough times; and I think going back to what Vitor was saying, the importance of having a framework whereby, whether it's the central bank setting the goal, so having goal independence, but it always has to have the operational independence of using the instruments under its hands to actually achieve that goal is extremely important.

And in the absence of well-defined frameworks that's where the fear of floating comes,

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and that's where things become very messy, and people don't understand what the central bank is doing. So, the same way of fiscals having monetary policy frameworks which are well understood by the public, and then trying to achieve the targets over and over to gain that credibility over time is key.

You had also mentioned in the past that IMF would sometimes debate with the authorities thinking that they have the higher intellectual say, I mean, having gone through two negotiations with the Fund, I feel that this concept of homegrown programs has become more and more integrated in the Fund's culture. So, compared to maybe the Turkish example a long time ago, where we are today, I think there's a lot of listening to the authorities.

There is a lot of also, I would say a quest towards more legitimacy by making sure that programs are actually debated in parliament or at least past parliament, so there is this political or politics of consensus among the groups. Thank you.

MR. DERVIŞ: Yes. Just a correction, I mean, for the record. That program in 2001-2002, the IMF was listening very carefully, not just to the Minister but to the whole Turkish Treasury and Central Bank. There was a long history of advising, debating and in many cases -- I mean, I was not really a politician, but at the political level found that the Turkish technicians, and the IMF technicians, and The World Bank technicians, basically agreed on 90 percent of the thing, and that the real issue was with politics. And so, you know, I just wanted to put that.

SPEAKER: Emerging markets take that program as a case study, the Turkish program, so I think it's --

MR. DERVIŞ: But there was really quite a bit of convergence of views and mutual support between the Turkish technicians and the IMF and World Bank technicians. I can give examples, but that's not the point today. Any other -- Yes?

SPEAKER: Just a brief question. (Inaudible). It was interesting, the 28-month, you know, where the secondary relative term is negative. As a control group, because the underlying factors are desired to hold on to power, not that democracy is the causal factor. Was there a chance to examine to non-democratic governments, and to see how they would, in terms of critical points change spending, but they have also access to coercive means democratic governments don't?

MR. HENNING: Can I layer a question on top of that? I thought that this chart, where

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the increase in investment spending by governments, was peaking 28 months before the election was curious. I thought that peaked too early, by mental model about how political fiscal cycles work. I would have expected the government to want to have that peak much closer to the election.

MR. GASPAR: Yes.

MR. HENNING: So, I was wondering whether there was a theoretical explanation for the timing of that peak.

MR. GASPAR: Yes. Well, thanks for both questions. I worked on that chapter together with Sanjeev, and Estelle who is somewhere here. So the thing is that, to your first question though, we looked at democratic regimes only, because it was about the months to the next election. And by definition autocratic regimes don't have elections, I mean that are competitive. They have elections basically to, you know, to select themselves, or whatever.

So, it was just about democratic governments. And then going to your point, at the beginning of the project we thought that, okay, initially one would expect politicians being willing to open up infrastructures and the schools and libraries closer to the elections, and that's actually what happens, but the things that peak in the growth of investment, happens before the beginning of the electorate because they have to be built.

So once they get to government you see the big -- you see growth of public investment. The rate goes up in the first two years really, the first 18 months, and then of course it goes down. And there's a theory behind, which actually will mention, which is Rogoff 1990 saying: okay, those good star, more visceral like, transfers, and pensions, and wages, wage increases in the public sector, especially in emerging alone, a competitor, given closer to the elections, because it's easier to influence because it's more visceral; whereas, public investment increases, it happens at the beginning, but that's a bit of the empirics on the connection with the theory.

MR. DERVIŞ: I know Carol has to teach a course. Carol, do you want to say a few words before you have to leave us?

MS. GRAHAM: Well, I think this is a great discussion, and I think the one thing that is probably a fundamental thing that we are now even dealing with in the U.S., that I think is at the root of a lot of the discussions -- but the makeup of the institutional rules and structure, in respect to those rules,

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and structure, and under what context can they be threatened? And then they matter even more. And under what context should be more flexible as in the EU context where, you know, I think you were giving some great examples. And how the IMF manages that, you know, is going to require more dexterity going forward, but I think it's a really, really useful discussion to have.

And the only other point I'd make, which I've certainly been finding in my work, and it really strikes me is that, we always think of the average voter in developed economies as being more informed and better educated. And yet my own experience and certainly (laughter) -- especially now watching what's been happening here, but also that the average sort of citizen in a lot of emerging market countries is much more economically savvy because, you know, the (inaudible) informal sector knows what the exchange rate is every day.

Do I keep my salary and domestic currency, or do I trade it in for dollars, or whatever it is? And I think it's time to sort of rethink some of those paradigms as well.

MR. DERVIŞ: Okay Carol. I'm not saying you should go, but if --

MS. GRAHAM: I actually should go, if you don't mind. (Laughter)

MR. DERVIŞ: Well, thank you very much.

MS. GRAHAM: Thank you. (Applause)

MR. DERVIŞ: And her book is out.

MR. GASPAR: May I react very quickly on this?

MR. DERVIŞ: Yes. Sure.

MR. GASPAR: So, two things. One that I should have said before but I forgot. In a representative agent model like many times we use as economists, there are no politics, right. You cannot possibly have politics in a representative agent model. You need to have androgyny to have politics, so in a sense that's another way of saying that politics require distribution considerations, even if there are other considerations as well.

The second aspect which is very important what Carol said is: how does the IMF tackle this issue of very different experiences around the world? And I do think that that is a crucial contribution from the book. So, the book is based also, to a very large extent, on datasets that are compiled by the IMF itself. We have a dataset of economic and political variables that covers 94 countries and for about

four decades. And that allows our analyses to provide cross-country comparisons.

We also have a database on fiscal rules that covers almost as many countries. Xavier was one of the promoters of that work. It's now researched that work is being continued in FAD as a very prominent work. And we have third dataset which is international, which is on fiscal institutions that covers 39 countries, and fortunately most of those 39 countries are advanced countries.

For the other datasets, we cover the three country groups that we normally focus on, advanced, emerging and low-income countries, and it's from the comparison of the experiences around the world that we determine what is best practice, what is likely to work, and where.

MR. DERVIŞ: Good. Vito?

MR. TANZI: Going back to my question that was ignored, although I thought it was a key question, you know. That we discuss rules as if rules were the tenth commandment, you know, it comes from God, and you have to follow it. But the truth is, that to take monetary rules, you know, Blanchard tells us that we should have 4 percent as the highest, or recently somebody else was proposing 3 percent. The Central Bank wanted to go after 2 percent. I always thought that zero was the right rule.

At the same time, I know that the central banks have not even been able to achieve the 2 percent. So, here there are two questions. One is the validity of the rule. There is more and more doubts today. You know, economists don't have the reputation that they had in the '60s, and what they say is always challenged. And the second is that the ability of the institution that are supposed to achieve, satisfy that rule to do it.

The more I see the working of countries and governments and central banks, the more doubtful I become that they are capable of doing that, because of a complexity, because of globalization, because of the effect of the irrational exuberance, or whatever. So, I would like to have some comment on this.

MR. DERVIŞ: You know, absolutely, Vito --

MR. GASPAR: And I thought I had.

MR. DERVIŞ: Just one second. I just discovered that yet another FAD Director was in the room, Carlo Cottarelli. But I don't --

MR. COTTARELLI: Don't (inaudible).

MR. DERVIŞ: Okay, okay.

MR. GASPAR: May I? So, I thought I had answered your question in the following way. First of all, in the Fund and in the Fiscal Affairs Department we are always examining rules, frameworks and institutions, try to see how they perform around the world and trying to push outward the frontier of best practice. And one of the works that that we have in the pipeline is about the next generation of rules. That is something that we expect to see in place in the next year or so.

I also made the point that rules should not in a sense be evaluated in a vacuum; and that in many instances rules work as designed when they emerge endogenously from the will of the fiscal system itself. When the fiscal system perceive that there is a problem, and the rule helps solving that problem and coordinating the various actors of the political system.

While, if the rule for whatever reason is imposed from the outside on the political system, the political system will find ways of working around it. And of course we can have a much longer debate about rules and how they work in practice, and that is always fascinating but it would take much longer.

MR. DERVIŞ: All right. We are coming to the end of this great session, and we have just maybe a few minutes left. And I want Vitor Gaspar to have the last words. But let me -- I see a few hands, but I think we've really run out of time, unless you can do it in a very telegraphic, like two-second type questions. Okay, you? Two questions, but really telegraphic. I also have one that I want to get in.

SPEAKER: This is my telegraph. At the heart to what you are discussing what I find is politics. But my question is about, how can you -- and this should be at the heart also of the debate between elections in democracies -- How can you explain these very complex set of principles and rules to the general public without sounding too technocratic and basically boring?

MR. DERVIŞ: Yes, very quickly?

SPEAKER: Hi. First, one comment: I heard Olivier Blanchard earlier this month during a lecture in the London School of Economics saying that he had changed his view about the 2 percent inflation target, and that he not comfortable with it, given that he was more convinced that negative interest rates would be more effective, more effective. My question is on the chapter of the book about low-income countries, and if you could give us a bit more information about what it says, and mostly thinking of countries where politics are more based on power, and not so much on institutions and rules.

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MR. DERVIŞ: Actually, the gentleman asked pretty much what I wanted to ask. But it seems that there has been a convergence of a kind of economists' views within certain boundaries compared to 20, 30, 40 years ago where some economists will say that the 20 percent fiscal deficit was no problem, or 20 percent inflation was okay.

I mean, we have reached a much stronger, not consensus, but agreement on some basics. But, we can't say that that agreement, and those details have become, in a more meaningful way part of the democratic consensus, I think. And that, I mean, that's at the heart of, I guess, that's why your book is so valuable I think, because you have to inject, you have to confront the two for this to emerge.

MR. GASPAR: So, let me take the second first, and yours.

MR. DERVIŞ: Yes, yes.

MR. GASPAR: And the first question last. So, we don't have a chapter on low-income countries in the book. We try to cover low-income countries throughout the book, and there are quite a number of examples and discussions about low-income countries. If you allow me to, again, draw on my own research. One of the results that we present in the book, is that we identify a tipping point for tax capacity that we measure as a tax to GDP ratio.

The estimate of the tipping point that we get, is at about 13 percent of GDP; that is for tax revenues, strictly speaking. So, it's not general revenues of government, it does not include social contribution, it does not include royalties, income from property, aid flows, it stacks. And we see that when countries go above that threshold there is an acceleration in growth that is long-lasting and significant economically and statistically.

Now, that is important for low-income countries because about half of low-income countries are below this threshold. So, if you think about development policy and fiscal policy as development policy, building state capacity, building tax capacity is at the heart of it. And I think that's a strong message for low-income countries, not the only one. Not the only one. There are things about the procedure for public investment, which is equally important for low-income countries. So, you have a lot on low-income countries in the book and, again, I would encourage you to go and see it.

Now, in terms of the democratic society, and the role of experts in a democratic society, the way I see it, is what I believe I learn again from John Rawls. John Rawls who was certainly an expert

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said that expertise does not have a special status in the democratic debate. It is incumbent on experts to be persuasive or be politically relevant.

And having just purchased your book of essays on various topics, which are very short and to the point, I do believe that you take that quite seriously yourself.

MR. DERVIŞ: Thank you very much. Thank you. Well, thank you Vitor. Thank you, all of you for having joined us here, and engaged in the debate also from the floor. I think it was a very enlivening debate, and I think many of us will read most of the book, let's put it that way.

MR. GASPAR: I appreciate it.

MR. DERVIŞ: Thank you very much. And come again. Thank you. (Applause) Şebnem and Randall, thank you very much.

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