

# Political Deficit and Bureaucratic Surplus

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## Abstract

This paper investigates effects of fiscal advisors to keep fiscal discipline of local governments when appointment of fiscal advisors is determined endogenously. We formulate a mechanism how outside advisors serve as a commitment device for local politicians who go for re-election when there is no legally binding fiscal rules such as balanced-budget rule, and test our hypothesis empirically using Japanese panel data of the prefectural governments. An incumbent local politician makes a decision on appointment of an outside agent as his adviser before he knows a type of his competence on the policy field that he has to work on. If the incumbent politician can commit to the fiscal discipline set by an outside advisor, and his competence happens to be low, he can avoid inefficient over-provision of public goods subject to the fiscal constraint and be re-elected. If his competence happens to be at a high level, the scale of his public good provision is also suppressed by this fiscal constraint below the level that he could choose efficiently without the constraint, but then, he can also be re-elected. Our empirical analysis supports this hypothesis, in a sense that local governments with directors from the central government accumulate less local debt. Our results also show that they cut back the investment in infrastructure so as to scale down the total expenditure and local debt, without decreases in the personnel expenses and subsidies or grants.

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