

Smaller Measurement Errors, Better Economic Policies?

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Abstract: More and more economic transactions leave a “digital footprint”, a trend that will improve the precision with which key economic indicators, such as GDP, inflation, or unemployment, can be estimated. We analyze the consequences of this trend for economic policy and performance in a political-agency model that includes fundamental uncertainty about the optimal design of growth-promoting reforms. We demonstrate that more precise economic statistics can inhibit--rather than stimulate--reform attempts. By improving the assessment of ongoing reform processes, better statistics more clearly expose reform designs that do not work and need realignment. For the incumbent government, this implies a higher risk of losing power in an upcoming election: when confronted with negative news on the economy, voters are less likely to give the government the benefit of the doubt. As a result, the government may prefer to play it safe and adhere to the less risky status quo. A basic implication of our model is that the effect of better statistics on economic performance is not unambiguously beneficial but depends on institutional factors, such as the degree to which politicians are held accountable to the voters.