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Abstract

I propose a general equilibrium model with a quasi-hyperbolic discounting government that optimally decides upon using creative accounting in order to evaluate a balanced budget rule and a debt rule. In that context, I find that a binding balanced budget rule could fail to properly constrain public overindebtedness when government uses creative accounting while a debt rule is effective, since targets are set on total public liabilities. Results suggest that a balanced budget fiscal rule can also deteriorate welfare due to the higher interest rates derived from doing operations under the line, implying future expenditure cuts that are harmful for households, who value public goods and services. A debt rule is also preferred for its capacity to reverse some welfare losses generated by the present-biased government.