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Discussion

Paul Wachtel

New York University

Fiscal Adjustment in EU Countries: A Balance Sheet Approach

Gian Maria Milesi-Ferretti and Kenji Moriyama

Paper provides 3 lessons and a conclusion

1. Difficult to define fiscal stance
2. Difficult to measure government wealth and savings
3. Governments have avoided efforts to become more transparent about their own data

→ Conclusion

Fiscal hanky-panky is widespread and easy

Summary of paper

- Three approaches to measurement
  - Balance sheet to determine net worth
  - Savings and investment flows
  - Intertemporal budget constraint
- Opportunity for shenanigans, e.g.--
  - Capital injection offset by (phony) financial asset
  - Tax on central bank capital gains
  - Securitization of income
- Measurement of aggregate extent of shenanigans

All measures are imperfect

- NW = FA– FL + K + V
  - Hard to measure government capital stock and revaluations
- FA-FL can be related to government income, expenditure and capital formation or a flow of savings account. Requires careful and consistent accounting to yield public sector borrowing requirement.

Tradeoffs –

- Changes in net borrowing are not the same as changes in net worth.
- Debt can fall without an increase in NW
- Move things back and forth from private sector to government sector.
- Transactions that can affect debt may or may not impact capital markets.

Easy shenanigans

- Capital injection or recap of firms
  - Provide capital – cash – in return for an equity interest or asset
  - No change in NW but improvement in budget balance (from FA)
- Securitization – real Italian creativity
  - Sell revenue stream

What is the problem?

- If Enron and AIG can do it, why can't the government?
- What is to be done? Disclosure and rule making
- But, who makes the rules? When we let private sector entities make their own accounting rules, we get trouble. But, governments are making their own rules.
- With all the increase in transparency (the golden word) in central banking and elsewhere, there seems to be little improvement in fiscal information.
- Indeed, the governments incentives are to stay opaque.

How serious is the problem?

- Simple correlation analysis
  - Two five year periods 92-97 and 97-02
  - 15 EU countries (at most)
  - No other variables held constant
  - No correction for simultaneity
- Early period – govts constrained debt by decumulating assets and effort stronger where debt high to begin.
- In later period – less incentive (in EU, on way to Euro) and weaker relationship.
- But, evidence not so strong; differences may not be significant.

Interpretation

- Governments took full advantage of opportunities for hanky panky when they were anxious to satisfy the new and demanding fiscal rules. But, the phenomenon was transitory and is already history.

OR

- Governments operate in an opaque world (that they themselves rule out in private sector) and have little incentive to change it. The data are poor and the accounting conventions unclear. As a result, govts make a mockery of fiscal rules and efforts to maintain fiscal discipline. The lack of fiscal clarity and policy coordination is a serious problem for the EU that has successfully unified monetary policy with a transparent and easily understood structure.

Interpretation

- I am not sure which is correct but this paper has made me curious to find out.
- The simple empirical section suggests the first interpretation – an adjustment phenomenon of the 90s.
- But, the discussion that precedes it suggests that the problem is pervasive and serious.