

# The 11<sup>th</sup> Dubrovnik Economic Conference

**“What do deficits tell us about debt? Empirical evidence on creative accounting with fiscal rules in the EU”**

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# The Case for Fiscal Rules in Monetary Unions

Monetary union →

cost of high  $\Pi$  and high  $r$  spreads  
to all members →

high fiscal deficits and debt →

fiscal rules to ↑ fiscal discipline

# However, fiscal rules → creative accounting:

- ◆ SFA ↑ in the EU after 1997
- ◆ SFA ↑ during downturns
- ◆ Intuitive specification, focusing on the negative correlation between SFA and deficits



- ◆ What if the rule is not binding? Does negative correlation  $\uparrow$  as  $\Delta B \rightarrow D^*$  (yes based on Table 5)
- ◆ Is SFA more than necessary in some countries? Why?
- ◆ Will deficit with no rules be higher than deficit + SFA with rules?
- ◆ Results robust to a number of tests, but no robustness tests for specification with cyclical effects

# What Explains the Size of SFA?



1. history of lack of fiscal discipline
2. high level of debt
3. high share of inflexible fiscal spending (wages, pensions)
4. too many large, loss-making public enterprises
5. domestic policy rules (Poland)
6. long-term liabilities
7. defense spending
8. infrastructure needs

# What Explains the Fluctuations of SFA?

- ◆ Business cycles:

SFA adj used to weaken the impact of the cycle on the deficit



# How About Political Cycles?

"...deficits don't matter...We won the congressional elections, this is our due."



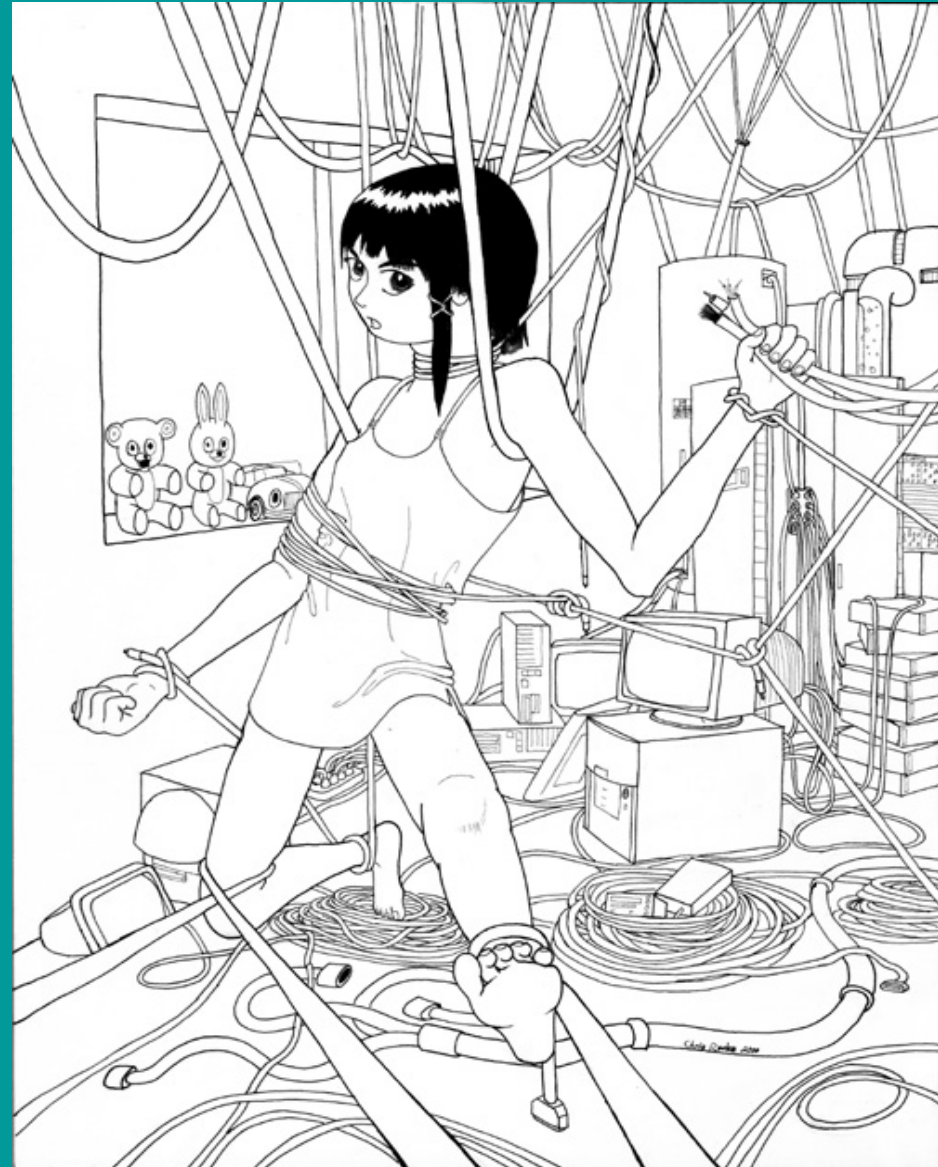


# How About One-Time Spending?



# Fiscal Rules → Wrong Incentives?

- ◆ 1-off measures, dividends, tax amnesties, window dressing
- ◆ lower public investment or use of PPPs



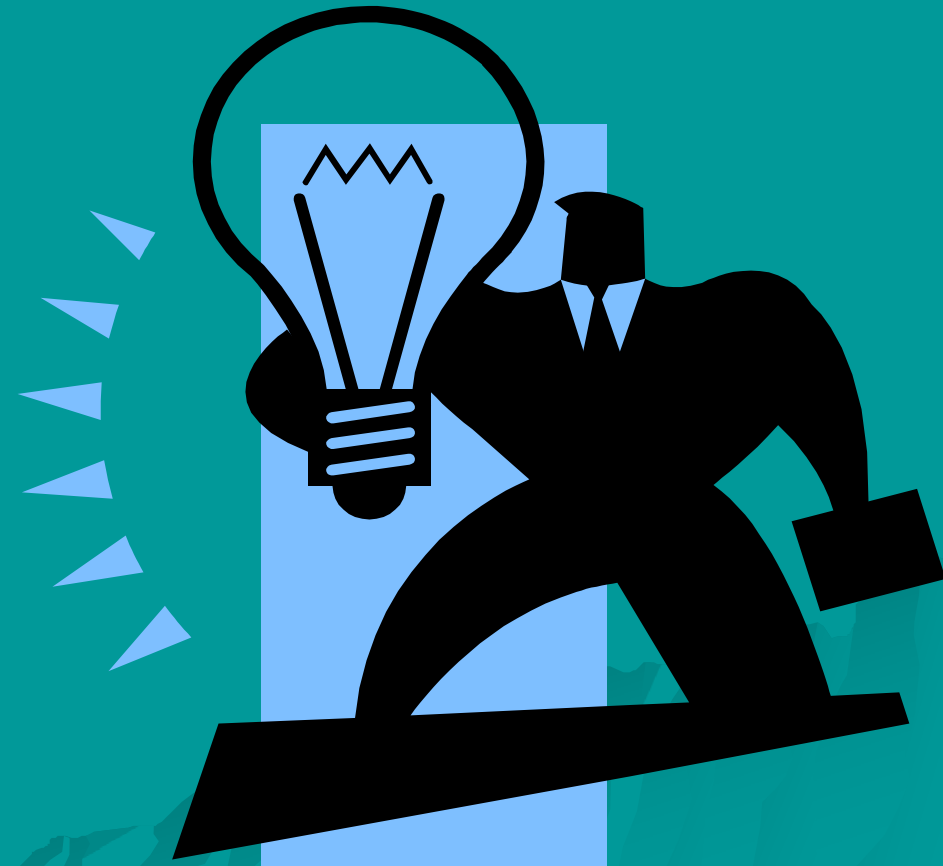
# The Question Remains

- ◆ Strengthen rules → rules on debt

Or???. . .

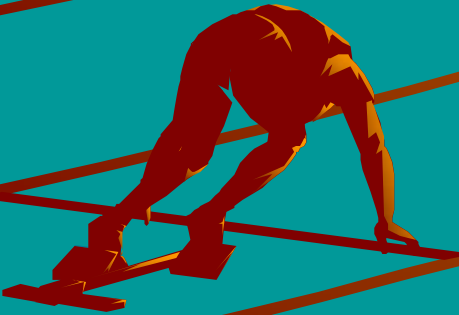


Be  
“Master of your Domain”

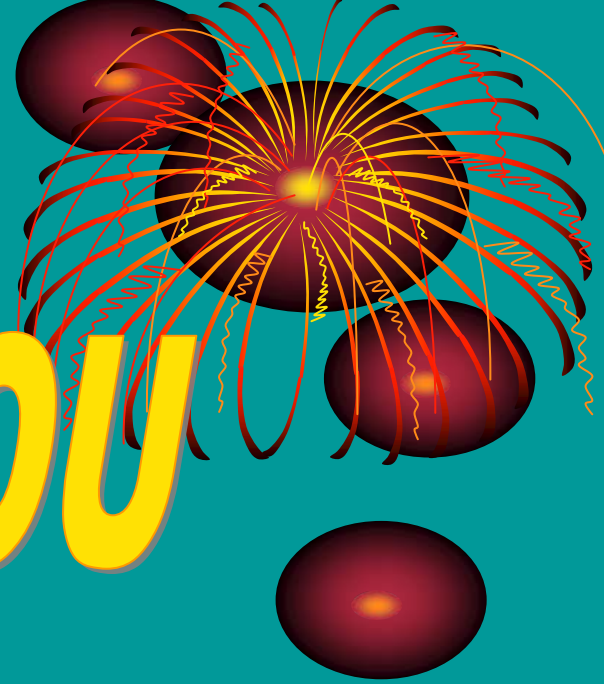


- ◆ Is lack of ownership the problem?
- ◆ Do self-imposed rules have more chances?
- ◆ Can countries design and enforce rules ensuring fiscal discipline and sustainability?
- ◆ Why not independent fiscal authorities?

We Have Just Started  
Scratching the Surface!!!



***THANK YOU***



***VERY MUCH!!!***