



Fiscal Surveillance in EMU: New Issues and Challenges

Measurement issues in budgetary surveillance

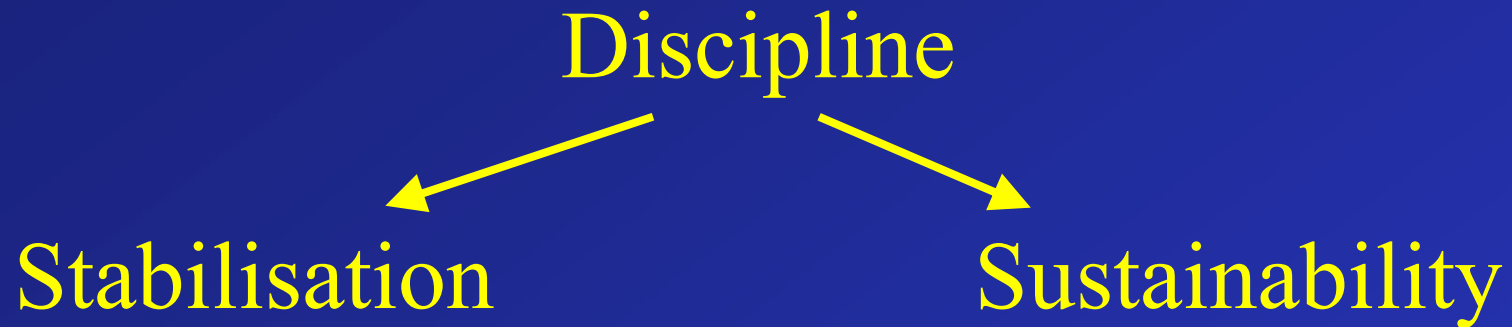
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The Stability Pact triangle



PITFALLS

Discipline

when the deficit ceiling is approached, incentives for creative accounting and one-off measures flourish (PvdN-VK)

Stabilisation:

the traditional view of automatic stabilisation is partial at best (JM)

Sustainability:

SGP suffers from short-terminism, but the current shift to (gross) debt is misguided (CW)



The EU fiscal rules, in a nutshell:

$$\hat{d} \leq 3\% + \alpha(Y^\circ - Y^*)$$

And what is wrong according to JM, VK,
PvdN and CW:

$$\hat{d}_{NA}^c \leq 3\% - \hat{d}_A^c + \alpha_j(Y^\circ - Y^*) + c_p$$



Discipline (*Koen and Van den Noord*)

Goodhart's law: I walk slowly, but if you try to catch me, I start running

- Stock-flow adjustment: strategic use in the arbitrage between deficit and debt rules
- Growth optimism bias helped to paint an overly rosy picture of public finances: politically motivated use of forecasts
- The odds of gimmicks increase with a deficit around 3% (not only with EDP) and for debt substantially above 60% (not just above it)
- Why exclude one-offs that temporarily worsen the recorded fiscal position?
Pension funds established in good times (IRL)
- Why a decentralised budget process favour budget gimmickry? According to the literature a decentralised process is more likely to get in fiscal trouble, but that effect is already captured by EXCESSDEF.
- Policy conclusions: escape Goodhart's law by monitoring more than one variable.



Stabilisation (*J. Mélitz*)

- The fact that the value of the CAB is not the same if one considers output elasticities of budget items in levels or as ratios on GDP is not surprising: PFR 2004, Annex II.1.
- Total expenditure elasticity (in levels) in the paper (-0.2) is the same as the EU simple average of the expenditure elasticity computed by the OECD.
- The 'large' stabilising effect of the expenditure-to-GDP ratio vis-à-vis the tax ratio follows from the fact that the largest part of expenditures is a priori not linked to the cycle. Automatic stabilisers and the stabilising effects of the government budget overlap but are not the same.



Sustainability (*Wyplosz*)

“It is better to be roughly right than precisely wrong” (J.M. Keynes)

- Assumptions that i) room for curtailing age-related expenditures is limited, ii) increases in age-related expenditures will increase deficits; i) not clear. ii) in contrast with evidence from the estimation of fiscal rules. >> combination of reform and discipline: in contrast with reform incentives?
- Making the world more Ricardian by increasing awareness. Is Germany the paradigm?
- Surveillance ranking: first best, net debt including implicit liabilities; second best, budget deficits; third best, Maastricht debt.
- What are the boundaries of implicit liabilities? All expenditures for which there are legal commitments or all future expenditures for which there is strong expectation by the government?
- If government financial assets are earmarked to spending categories or used to hedge government finances, they are less liquid than debt. Governments hold assets only if these are not perfect substitutes with government debt. So, can we deduct meaningfully government assets from liabilities?
- Structural reform and the SGP: moral hazard problem. Leave it to the Council and “all reforms – or talk of reforms - are good reforms”