Fiscal union and the need for accurate macroeconomic statistics

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- The euro area crisis
- The new institutional setup
- Importance of macroeconomic statistics
- Towards fiscal union
- Creative fiscal accounting
- Heterogeneity of accounting standards in Europe
Instead of using OMT date, please show date of Draghi speech in London. For BU, please show that European Council announcement "We break the vicious circle between banks and sovereigns."

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Sure

Uuriintuya Batsaikhan;
Measuring competitiveness divergence

ULC-based real effective exchange rates (vs. EA18)

Source: ECFIN
Current account statistics

Current account balance (in bn EUR)

Source: Bruegel based on AMECO, Eurostat
Key governance decisions already taken

- European Stability Mechanism (ESM)
- Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (TSCG)
- Sixpack
- Banking Union (BU)
- OMT programme
- 5 Presidents’ Report further proposes:
  - Advisory European Fiscal Board (stage 1)
  - Euro area stabilization function (stage 2)
The new EU fiscal framework puts more emphasis on the so-called „structural“ deficit. It is computed with GDP and „potential“ GDP data.

Well established empirical finding that GDP revisions are significant (see real-time literature, Cimadomo 2011 survey).

Macroeconomic statistics clearly matter for fiscal policy decision making.
Real – time errors in budget procedure.

Figure 1: Successive releases of data for the general government budget balance (in % of GDP) for Greece as reported by Eurostat in the context of the spring and autumn Excessive Deficit Procedure (EDP) Notifications. Source: de Castro, Pérez and Rodríguez (2011).
Macroeconomic Imbalances Procedure

- It is part of 6 pack
- Significant emphasis on concept of „competitiveness“
- Growing literature on the need to measure competitiveness with micro-economic data.
Fiscal Union?

Ratio of local to general government expenses in 2013 (%)

→ Fiscal policy is basically national.  

Source: IMF, Government Finance Statistics  
Note: Federal countries in dark blue.
Fiscal Union: Basics

Musgrave and Musgrave (1989):

- **Purpose of budget**
  - Finance public goods common to all federal states
  - Correct geographical and historical disadvantages, maintain national cohesion
  - Smooth business fluctuations

expand or re-orient EU budget?

complement EU and national spending with spending at different levels (EA, Schengen)?

In EA, case for fiscal stabilization is strongest, allocation and distribution not primarily EA issues
Stabilization channels

- Capital and credit market channel by far the most important ones

Source: IMF (2013)
Creation of sizeable federal budget not realistic given the degree of political and social integration of the EU...

Need for fiscal policy coordination
- Interaction between monetary and fiscal policies
- Fiscal policy may supplement monetary policy
- Direct cross-border effects of national fiscal policy

Has been unsatisfactory so far (see next slide)
Stabilization through National Budgets

Fiscal impulse (% of GDP) and discretionary fiscal policy (% of potential GDP) in EA

Source: AMECO and own calculations
Notes: Crisis: countries under ESM programme; SGP: countries under corrective or preventive arm
Authors also show that implementation of recommendations not better than in the case of OECD recommendations.

Source: Darvas and Leandro (2015)
More pressure to reduce the debt ratio in normal and good times to allow for fiscal stabilization in bad times

Potential debt restructurings to prevent overly-harsh austerity and make rules more credible
  • Complete Banking Union with incentive to diversify banks’ exposure to sovereign risk
  • Deposit guarantee scheme with common fiscal backstop
  • ESM as firewall in case of sovereign debt restructuring

Important role of European Fiscal Board

But conundrum of shared sovereignty remains
National Fiscal Policies

- **Flexibility of SGP rules in bad times (for the short term)**
  - European Fiscal Board
  - National adjustment accounts

- **But avoid fuzzy discretion**

- **Need to coordinate a fiscal stance, in particular at Zero Lower Bound**
Fiscal rules aim at constraining government behaviour
To circumvent such rules governments sometimes revert to creative accounting
Empirical evidence of creative accounting in the EU (von Hagen and Wolff, 2004):
  • SGP rules have induced governments to use stock-flow adjustments to hide deficits  
  • Tendency to substitute stock-flow adjustments for budget deficits is strong for the cyclical component of the deficit (as in times of recession the cost of reducing the deficit is particularly large)

→ The amount of creative accounting depends on the reputation cost for the government and the economic cost of sticking to the rule
→ Again points to the importance of quality statistics
The closer we get to fiscal union, the more high quality and harmonized data is needed

- Base for fiscal rules and policy recommendation
- Limit procyclicality of current fiscal policy
- Identification of good and bad times

It is about national policies and data

Address circumvention of rules through creative accounting
**Complex and heterogeneous**
- Cash basis vs. accrual accounting?
- Federal systems often exhibit the most complicated systems, as different federal regions stick to different accounting principles

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<th>municipality level</th>
<th>Social insurance</th>
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*Source: Ernst&Young, European Commission*
Conformity to IPSAS?

- A Ernst&Young study reveals how similar accounting systems in the single EU member states are to the IPSAS
- Result: the conformity ranges from 30% to 90%

Source: Ernst&Young, European Commission
Fiscal policy making is at the heart of European crisis response.

It requires adequate macroeconomic information.

The more „fiscal union“ advances, the more relevant will be the comparability and accuracy of national fiscal and macroeconomic statistics.


Large heterogeneity of fiscal accounting approaches in EU.
Thank you for your attention!

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References:
Darvas, Zsolt and Àlvaro Leandro (2015). ‘The limitations of policy coordination in the euro area under the European Semester’. Bruegel Policy Contribution. 2015/19