

# **Fiscal union and the need for accurate macroeconomic statistics**

Guntram Wolff, Bruegel

Luxembourg

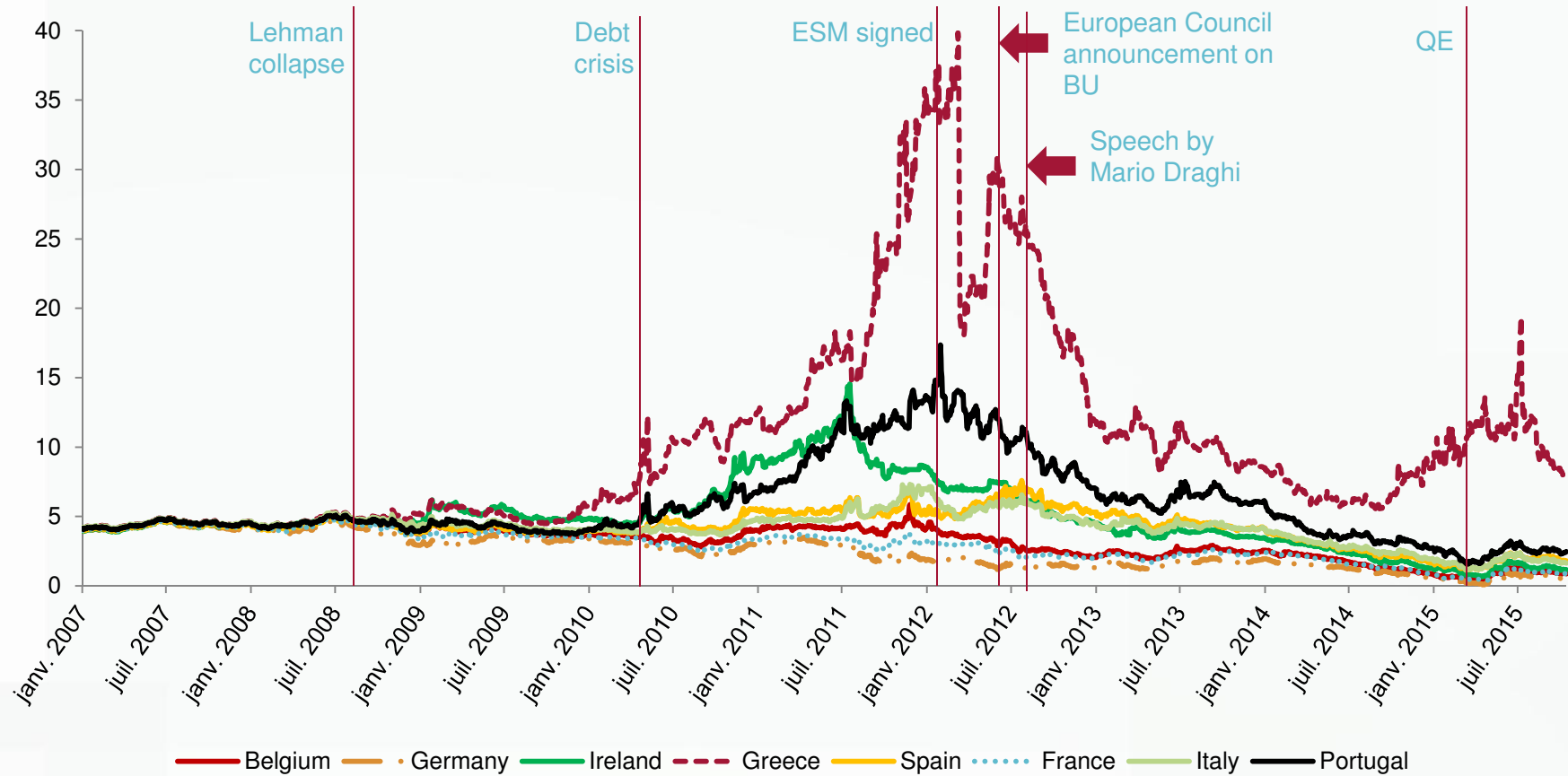
26 Jan 2016

# Outline

- **The euro area crisis**
- **The new institutional setup**
- **Importance of macroeconomic statistics**
- **Towards fiscal union**
- **Creative fiscal accounting**
- **Heterogeneity of accounting standards in Europe**

# Timeline of events

## 10-year government bond yields (%)



Source: Bruegel based on Datastream

### Slide 3

---

**1** 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."

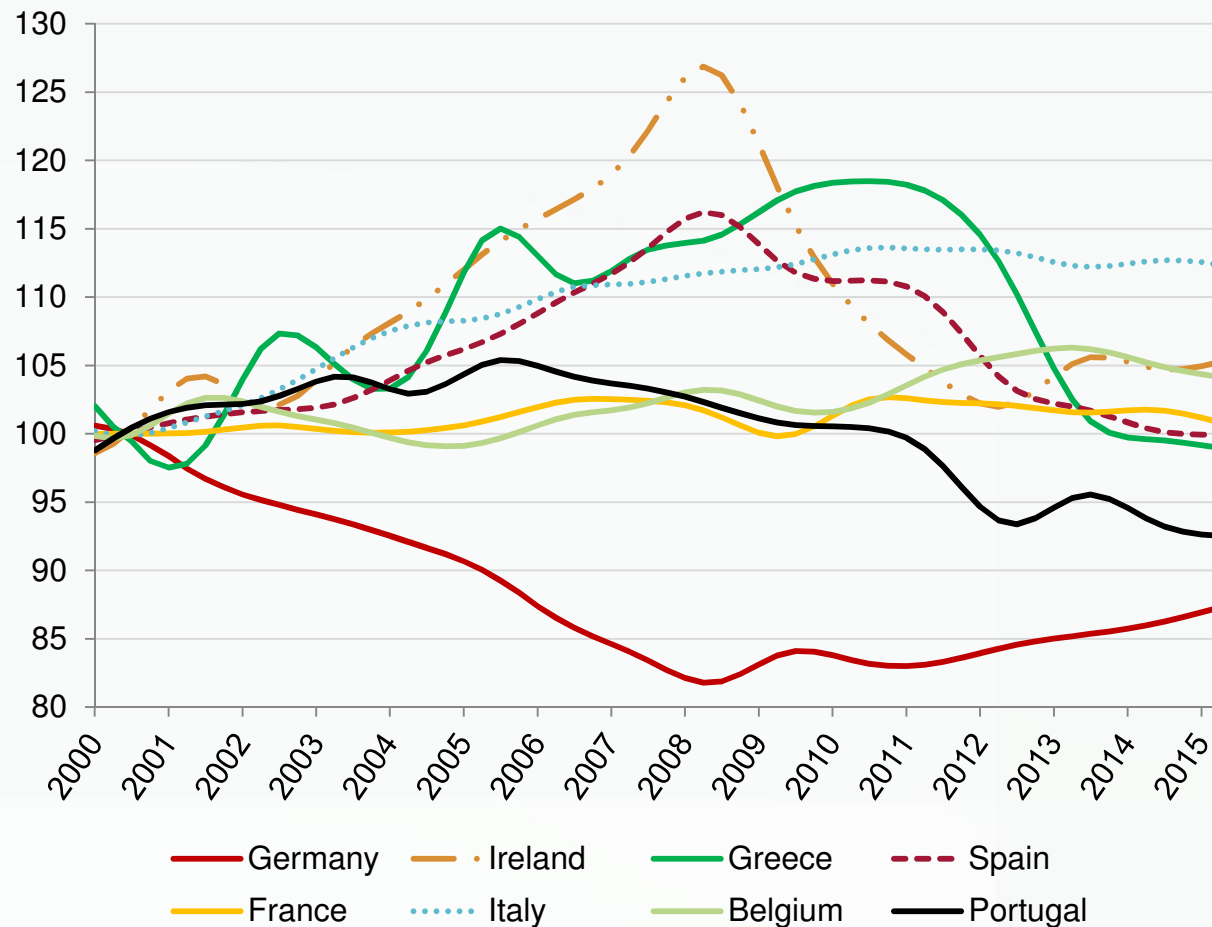
Guntram Wolff;

**1** **sure**

Uuriintuya Batsaikhan;

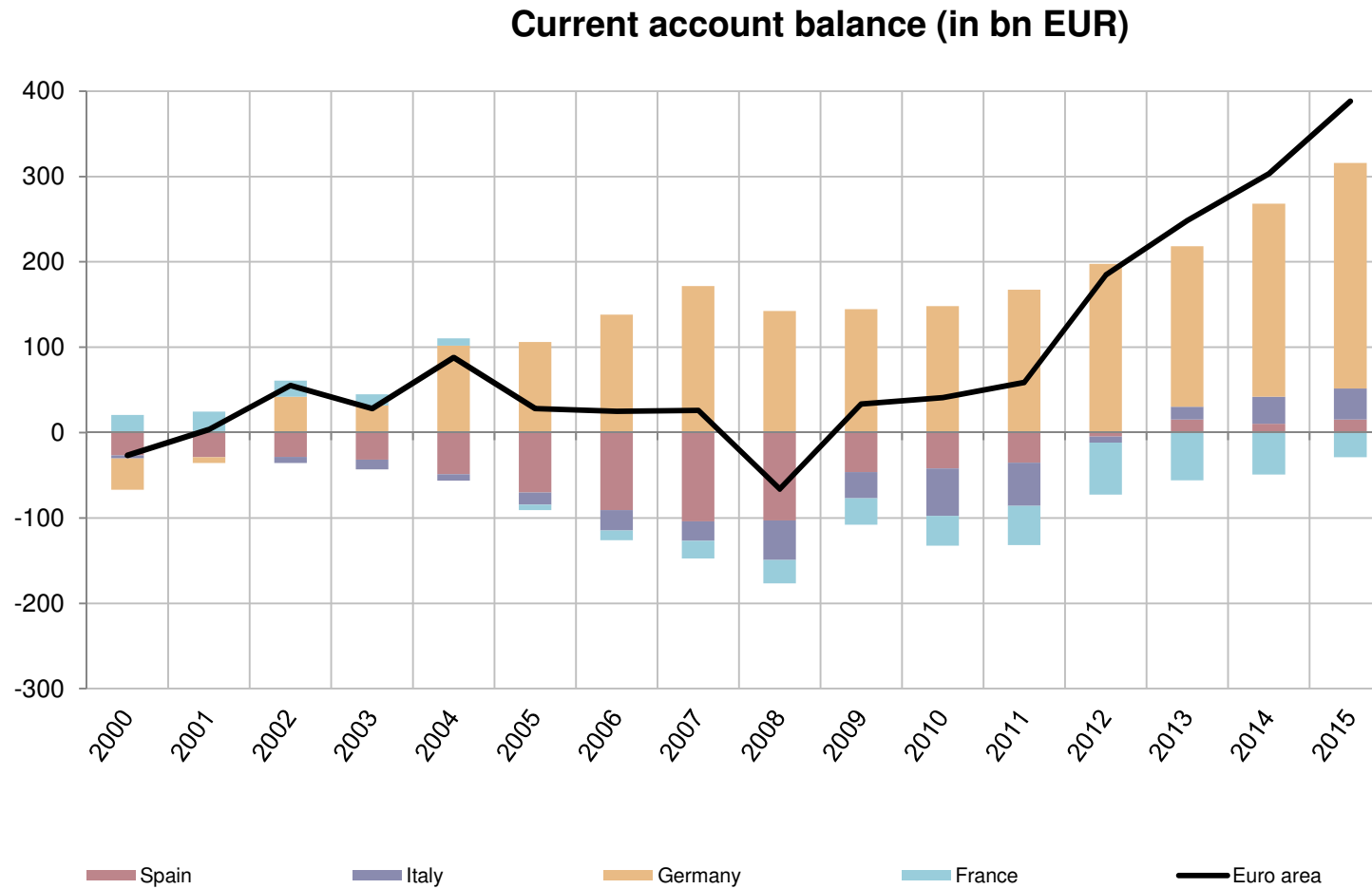
# Measuring competitiveness divergence

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



Source: ECFIN

# Current account statistics



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)**

# Fiscal framework and macroeconomic statistics

- **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.

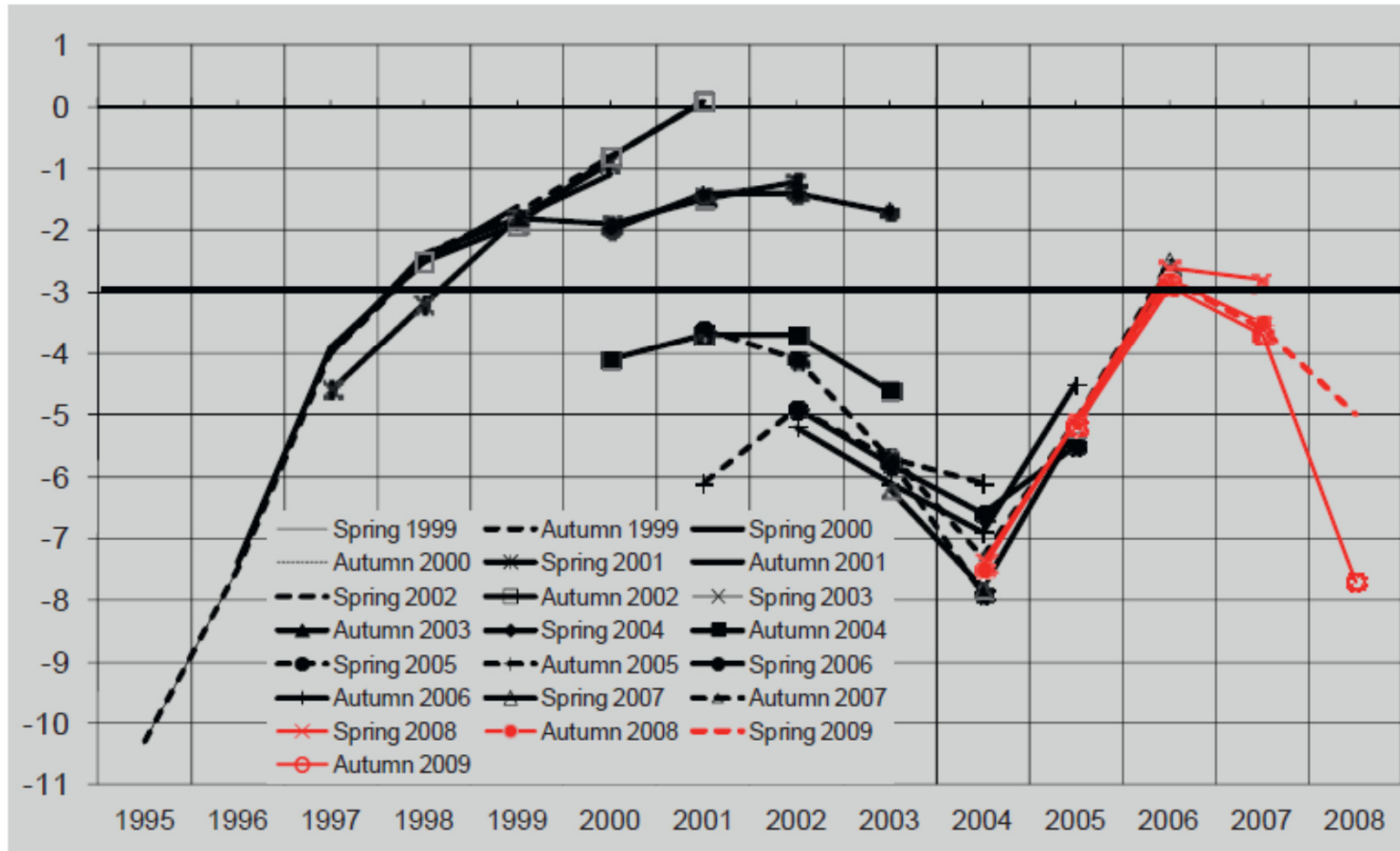


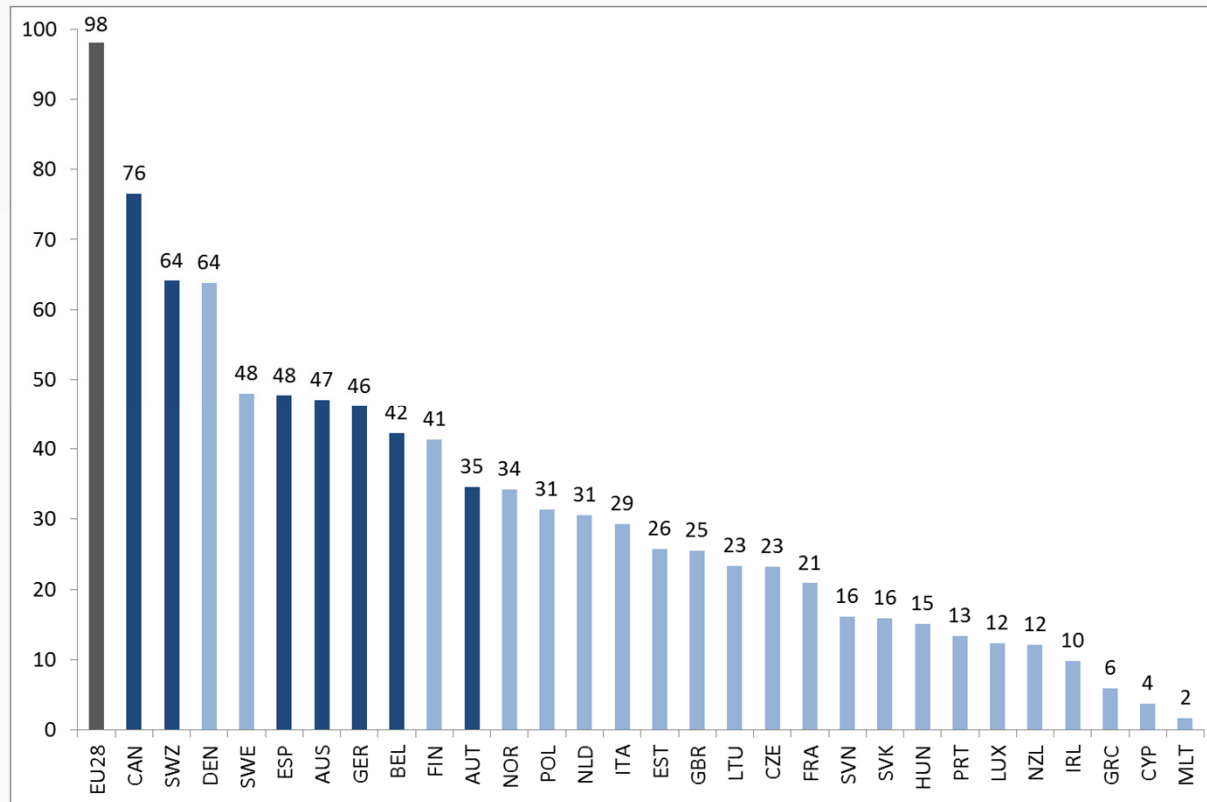
Figure 1: Successive releases of data for the general government budget balance (in % of GDP) for Greece as reported by Eurostat in the context of the spring and autumn Excessive Deficit Procedure (EDP) Notifications. Source: de Castro, Pérez and Rodríguez (2011).

# 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.**

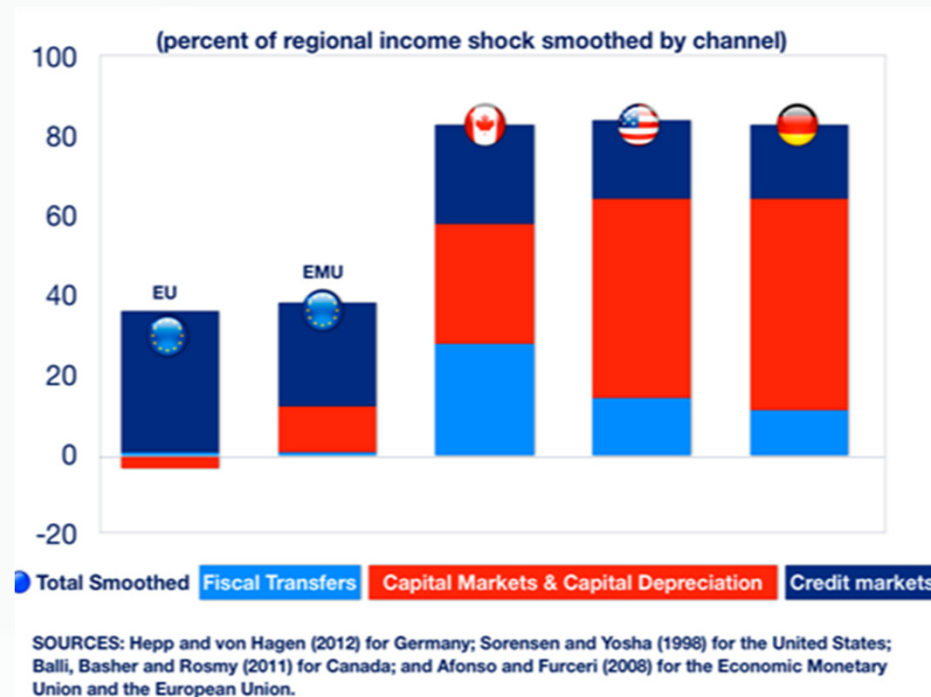
Source: IMF, Government Finance Statistics  
Note: Federal countries in dark blue.

# 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**



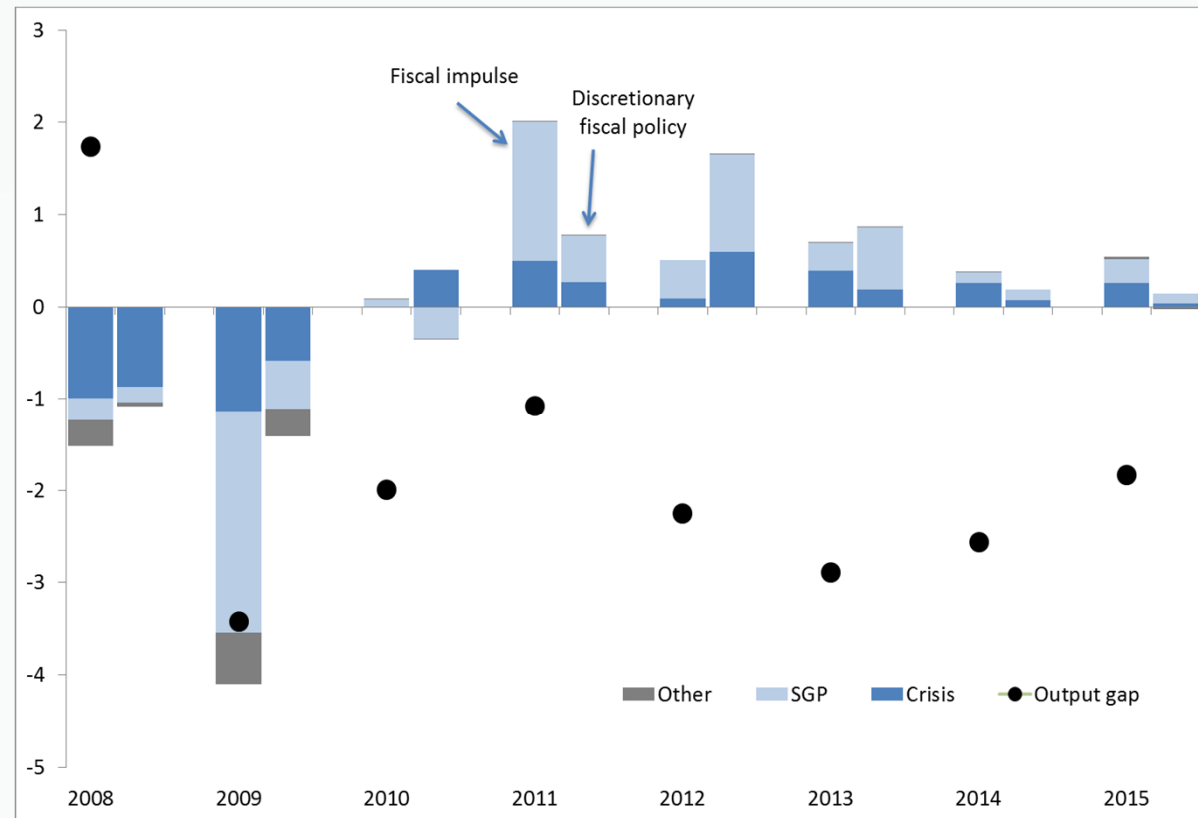
Source: IMF (2013)

# Stabilization through National Budgets

- **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**

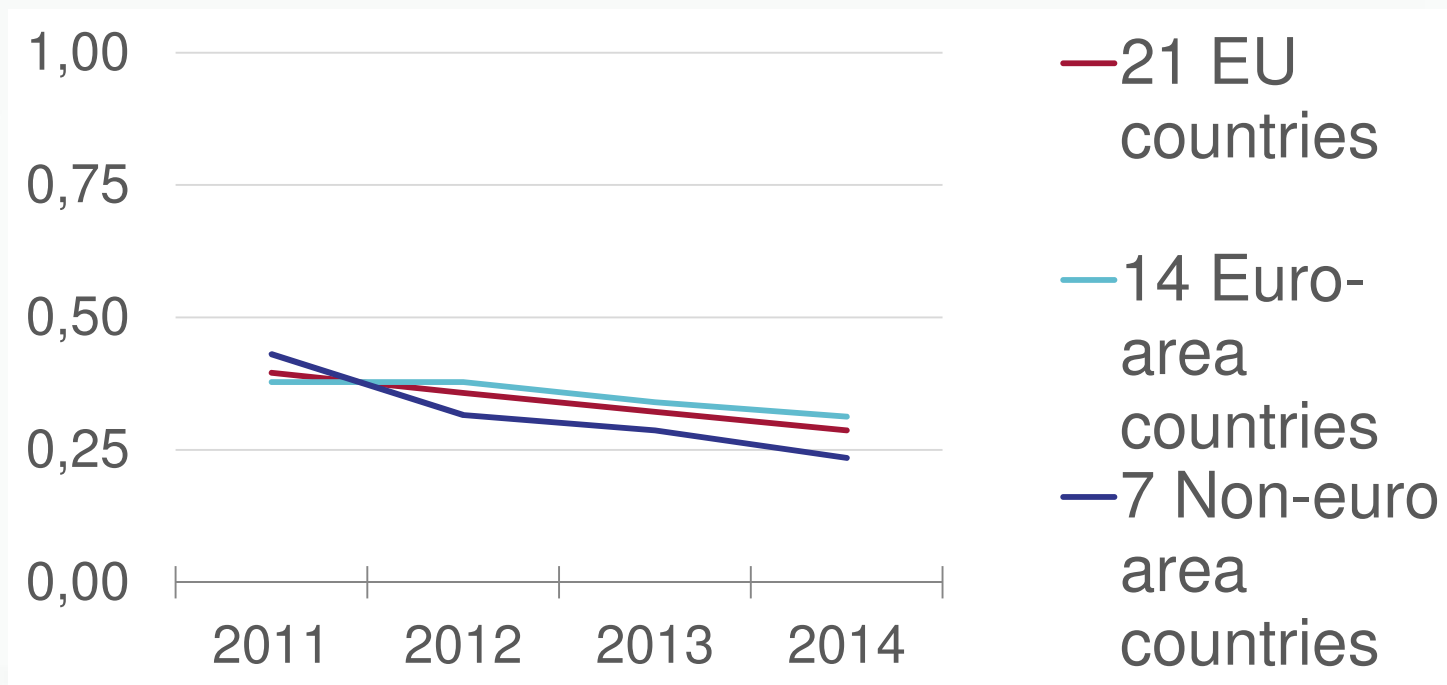


Source: AMECO and own calculations

Notes: Crisis: countries under ESM programme; SGP: countries under corrective or preventive arm

# European Semester and Policy Coordination

European Semester Reform Index



→ Authors also show that implementation of recommendations not better than in the case of OECD recommendations

Source: Darvas and Leandro (2015)



# National Fiscal Policies

- **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**

# Creative accounting

- **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**

# Implications for Public Sector Accounting

- **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**

# Accounting systems in Europe

- **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

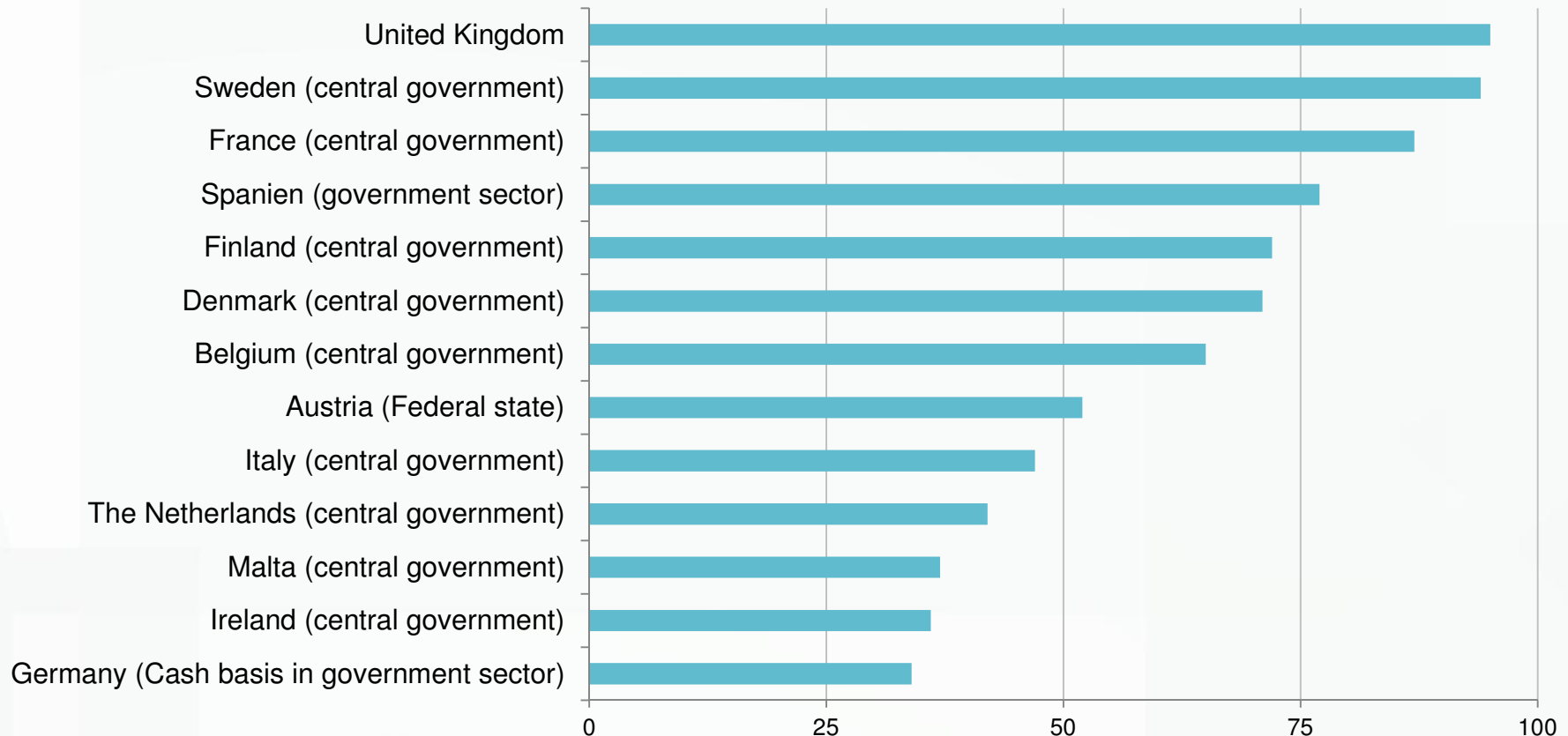
	At the central level	Regional level	municipality level	Social insurance
<b>Accrual accounting</b>	12	2	14	13
<b>Modified accrual accounting</b>	5	-	4	4
<b>Combination between accrual accounting and cash basis</b>	5	1	7	4
<b>Cash basis</b>	4	-	-	1
<b>Not applicable</b>	-	23	-	1
<b>No answer</b>	1	1	2	4
<b>Total</b>	<b>27</b>	<b>27</b>	<b>27</b>	<b>27</b>

Source: Ernst&Young, European Commission

# Accounting systems in Europe (i)

## ▪ **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

# Conclusions

- **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.**
- **Significant evidence of „creative“ accounting**
- **Large heterogeneity of fiscal accounting approaches in EU**

**Thank you for your attention!**

*Guntram.Wolff@bruegel.org*

**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*

*IMF (2013). 'Towards a Fiscal Union for the Euro Area: Technical Background Notes'.*

*Von Hagen, Jürgen and Guntram B. Wolff (2004). 'What do deficits tell us about debt? Empirical Evidence on creative accounting with fiscal rules in the EU'.*

*Discussion paper No 38/2004. Deutsche Bundesbank.*