Discussion of A. Tieman (IMF) “Fiscal risks: public sector balance sheet approach”

AIReF Workshop on Fiscal Risks

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The views expressed are mine and do not necessarily reflect those of the ECB or the Eurosystem.

General remarks

- I commend Alexander and the IMF for the latest Fiscal Monitor.
- The theme is well-chosen, topical and highly policy relevant.
- Fiscal policy buffers are essential to weather adverse economic shocks. Unfortunately, many countries today lack such buffers in the aftermath of the great financial crisis.
- One indicator for lack of buffers is very high government debt.
- The FM shows that a comprehensive view requires to look beyond general government debt as recorded in the national accounts, broadening the analysis to:
    - the public sector (public corporations)
    - account for the asset side (both financial and nonfinancial assets)
    - account for implicit and contingent liabilities
    - take an intertemporal perspective
- The FM provides a wealth of new data that will prove useful for further research.
- Finally, the FM provides tentative evidence that balance sheet strength reduces sovereign yields and increases resilience to adverse shocks.

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Comments on the data

- One of the most important challenges facing European countries is dealing with the (fiscal) implications of demographic ageing.
- The FM in static PSBSs includes only pension obligations owed to public sector employees, which on average amount to 46% of GDP in the sample of 31 countries with full PSBSs.
- This is just a very small part of total pension entitlements.
- European statistical agencies are in the process of putting together comprehensive data on pension entitlements of private households under PAYG social security systems. (For data so far available see: https://ec.europa.eu/eurostat/web/pensions/other-information)
- Take Germany as an example (reference year 2015):
  - Entitlements of public sector employees: 41% of GDP
  - Total pension entitlements: 291% of GDP
- Of course, the net present value of future social contributions would need to be accounted for as well. But based on current legislation there is likely a gap, to be reflected in net wealth.

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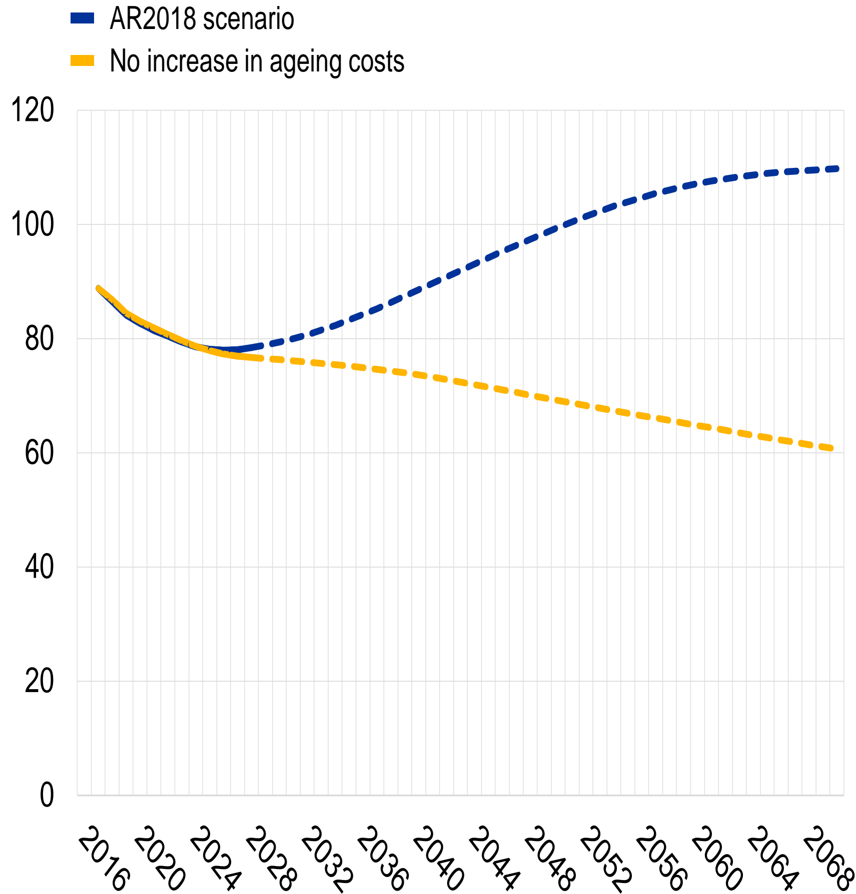
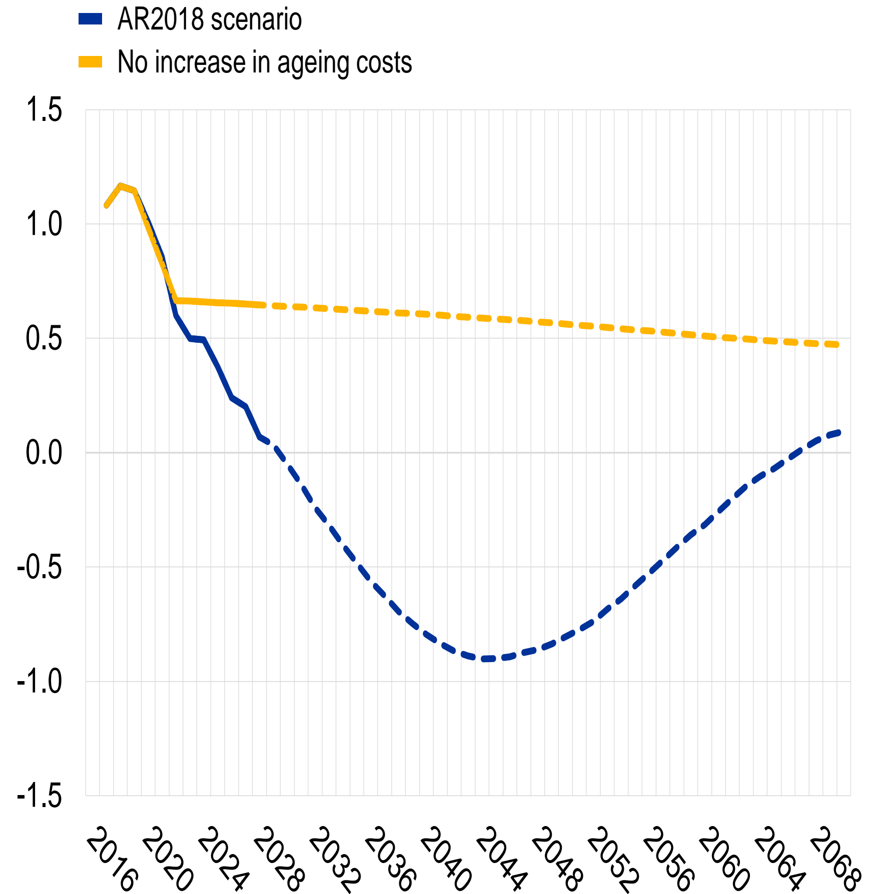
Ageing costs – if left unchecked – will increase euro area debt / reduce net wealth





Sources: EC 2017 Debt Sustainability Monitor (DSM), updated with EC Spring 2018 forecast until 2028 ("baseline no-policy change scenario"); as of 2029 ECB staff calculations based on DSM methodology as well as macro and ageing-cost assumptions from EC 2018 Ageing Report. The "no increase in ageing costs" scenario assumes that ageing costs remain constant at their 2016 level throughout the simulation horizon.

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Comments on the analysis

- Impact of PSBS strength on sovereign yields
  - Impact of public debt on yields rather low (10 pp of GDP increase in debt implies 10 bps increase in yields); widely cited 2009 JEEA paper by Laubach finds an impact 3-4 times larger
  - It would be useful to test for non-linear effects and to include further controls such as private debt, CAs or NIIPs which have been found to be relevant yield/spread determinants in the literature
  - It would be useful to have results for subset of EA countries
- Impact of PSBS strength on resilience to shocks
  - why do you use a dummy rather than the level of net wealth?
  - would the results look different if you used public debt instead of net wealth?
    - Romer and Romer (Philipps lecture, Economica 2018) show that countries weather shocks better if they have more policy space (in terms of interest rate above lower bound and low government debt)

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