COMMENTS ON SESSION 4
THE LEGACY OF THE CRISIS AND THE EXIT STRATEGY

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1 Comments on "The New Medium-term Budgetary Objectives and the Problem of Fiscal Sustainability After the Crisis" by Paolo Biraschi, Marco Cacciotti, Davide Iacovoni and Juan Pradelli

This interesting paper discusses the new methodology that has been developed to determine medium-term objectives (MTOs) for the structural budget balances of EU Member States. The new methodology is supposed to provide the transparent quantitative basis for determining MTOs that is currently lacking. It is therefore rather strange that the algorithm is not available, despite countries having used it to derive MTOs for 2009 Stability and Convergence Programmes. However, this paper contributes to transparency by deriving the algorithm for reported MTOs. A good bit of guesswork is involved, but it is difficult to believe that the authors are way off the mark. Moreover, their conclusions, which are that the new methodology appears to be weak in terms of the speed with which debt ratios are brought back to 60 per cent (the supplemental debt-reduction effort) and the incentive to reduce implicit pension liabilities, are probably robust.

In terms of detail, the explanation of the way the algorithm is derived would benefit from a clear mapping of MTOs that are designed to provide a safety margin, achieve sustainability, and accommodate growth-oriented spending and fiscal stabilization to the specific focus on the maximum MTO implied by the safety margin, the commitment to achieve a structural deficit no larger than 1 percent of GDP, and a combination of the debt stabilizing budget balance, the deviation of the debt ratio from 60 per cent of GDP, and implicit liabilities. This section of the paper is quite heavy going, and could be made easier for the reader.

The paper then proceeds to look at the impact of the recent financial and economic crisis on MTOs. The paper argues – in my view quite correctly – that fiscal stabilization and financial sector support costs have weakened debt positions and increased implicit liabilities in many countries and the fiscal adjustment strategies implied by the tighter MTOs that result could prove counterproductive for economies trying to recover from recession. The calculations of the impact of the crisis on MTOs reveal some large changes in MTOs that could indeed threaten fledgling recoveries if translated into front-loaded fiscal adjustment.

In the final section, the paper proposes an alternative approach to thinking about the required supplementary debt-reduction effort. The idea is that the risk created by particular debt level depends on a variety of factors that vary across countries, and it would be better to focus on some of these factors, and not on deviations from a common target, in deriving the supplementary debt-reduction effort a country should make, and thus its MTO. To this end, the authors construct an exposure index based on characteristics of government debt (level, composition and rollover requirements) as well as other domestic and external imbalances. This is a valuable contribution in an EU context, but the authors could acknowledge similar work that has been done on emerging markets with the specific objective of determining the "debt tolerance" of different countries. The authors should also review their discussion of the country estimates of the exposure index. These are generally as one would expect, but their interpretation, and that of the revised MTOs associated with the exposure index, may need to be modified in light of developments in southern Europe.

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2 Comments on "Implications of the Crisis for Public Finances: The Case of Austria" by Lukas Reiss and Walpurga Köhler-Töglhofer

Many countries have suffered larger output losses and sharper deteriorations in their fiscal positions because of the financial crisis than Austria. But the debt will continue to grow in the absence of fiscal adjustment, and the 4 percentage points of GDP adjustment required over the medium term to satisfy the conditions of the EU fiscal framework, cover the rising costs of population aging, and provide room to respond to future crises, while much less than in some other countries, is certainly no small matter.

Against this background, the emphasis that this paper places on growth-oriented adjustment is welcome. If the adjustment measures are of good quality, the more likely it is that adjustment targets will be met without imposing unnecessary economic and social costs.

The authors favor expenditure cuts, which are the source of most successful adjustments, but the paper does not say very much about where the cuts should fall. Rather, the authors place their faith in the new medium-term expenditure framework (MTEF) and budget structure. Not enough detail is provided to compare the MTEF and budget structure with best practice, but if budgets are guided by well-designed strategies and linked to results, then there is a good chance that the quality of budgeting will improve and cuts will reflect a careful prioritization of spending.

The paper is more precise on tax changes, favoring specific tax increases that are "growth-friendly" (*i.e.*, higher property, fuel, alcohol and tobacco taxes). These recommendations are fine as far as they go, although the best thing for growth would be to reduce the high explicit and implicit marginal tax taxes rates on labour. Piecemeal tax increases are not a substitute for comprehensive tax reform, especially over the medium-term.

The remainder of the paper focuses on supporting structural reforms, especially to increase labour supply, which seem appropriate, and the dangers of relying on inflation or bracket creep to reduce debt, which are widely understood. I would have preferred that the paper drop these sections, which do not add much, and instead spell out and justify an adjustment strategy in more detail.