

COMMENTS ON SESSION 4 POLICIES TO PROMOTE SUSTAINABLE GROWTH

*David A. Heald**

I have three papers to discuss, and I will not pretend that there are common themes. The first is the paper by Balázs Égert about debt thresholds, then the paper by Jérôme Creel, Paul Hubert and Francesco Saraceno about the effects of alternative fiscal rules, and finally the paper by Ernesto Rezk, María de los Ángeles Mignon and Agustín Ramello De la Vega about human capital growth, with particular reference to Argentina. I am not an econometrician; my interest is on the public policy side. There are people here who know far more about the econometric methodology and are better able to argue about that than I am. So, other than asking one or two questions, I am not going to talk about that aspect.

Turning to the Égert paper from OECD, I think that is very interesting because there does seem to be something of a policy demand for evidence that there are thresholds. I sense that, given how high debt ratios are now, there is a policy demand for saying that they are now too high: above 90%, that is damaging. The Égert paper convinced me that the Reinhart and Rogoff (2010) results are not robust. I am not quite sure whether the argument is that there are no thresholds or whether the endogenous thresholds around 20% and 50% ought to be taken seriously.

The paper makes clear its counter-intuitive result that, beyond 90 per cent, the effects on growth become less negative or neutral; that is obviously extremely worrying in terms of making intuitive sense. And the question I would throw out to the author, and other people working in the field, is to what extent that is a result of the particular data or of the particular econometric techniques that are used. As a user of this kind of research, when the results are counter-intuitive, one needs to understand what exactly is driving those results.

It is not heavily emphasised in the paper but one of the points I noticed was the fact that the Reinhart and Rogoff data are not publicly available, and there has had to be a reconstruction which makes this paper not an exact replication of their work. The Égert data analysis looks at two time series; a long series from 1790 to 2010 that looks at central government debt; and a shorter time series from 1960 to 2010 that looks at general government debt rather than central government debt. The results are not substantially different. But that provoked a number of reflections on my part, very much about whether one ought to be thinking about central government debt or general government debt or public sector debt.

I am a Professor of Accountancy and one of the things that I have very much noticed is arbitrage techniques using accounting rules, particularly in the context of Public-Private Partnerships (Heald and Georgiou, 2010 and 2011a) and also exploiting the difference between general government and public sector (Heald, 2012). As fiscal austerity bites and with fiscal consolidation generally, one should start watching for arbitrage mechanisms. These might damage value for money; they are also going to contaminate the macroeconomic data.

The second point is that net debt misses lots of things, pension liabilities having been mentioned several times in this Workshop.

The third point I would make is that, in public debate, there is remarkable neglect of the assets side of the public sector balance sheet. In accruals-based government financial reports, the focus is on the net assets figure or in national accounts the net worth figure. Now I recognise that the data often are not very good but, when one is thinking about what kind of policy response there

* University of Aberdeen.

should be to particular levels of government debt, I would want to have some idea what the assets side of the government balance sheet looks like. You could be a country with very good infrastructure assets and a relatively high level of debt, but might well be in a better position than a country with very poor infrastructure assets and a lower level of debt. As an accountant, I want to think about both sides of the balance sheet. The United Kingdom has now produced Whole of Government Accounts and that is one of the issues that academically I have been working on (Heald and Georgiou, 2011b).

So my questions about the Égert paper are:

- a) to what extent do the different results from Reinhart and Rogoff (2010) depend on the data used or on the econometric techniques used?
- b) particularly with regard to the data, are the results driven by certain countries and certain years or certain periods within those very long time series?
- c) is the policy conclusion that there is not an obvious threshold? I will come back to the debt issue during the discussion of the Creel *et al.* paper.

Francesco Saraceno presented the paper extremely well, so I am not going to talk about what he and his colleagues did (Creel *et al.*, 2012); other than make the point that this is modelling, from outside the official institutions, of the new European Union fiscal rules. The paper chooses four formulations of possible fiscal rules.

This raises in my mind two questions. First of all, do the modelling assumptions, which are described as New Keynesian, determine the results? To what extent do the judgements made behind the model building prejudice the results that are going to be achieved? Secondly, given the fact that this is unofficial modelling, it makes me interested in what official modelling has been done within the European Commission or elsewhere. The Creel *et al.* results favour the old UK-style golden rule (where investment is outside the golden rule) rather than the new European fiscal compact. Would alternative modelling, which can be defended on technical economic grounds, generate different results? I worry that sometimes economic and political judgements can become obscured by modelling complexities. Would differences in results – between the Creel *et al.* model on a New Keynesian basis and an alternative official model that may lie behind the European Commission and Council decisions – be driven just by different assumptions on how the economy works? A far broader range of people can become involved in discussions about how the economy works than in the econometric arguments.

Table 3 shows what Creel *et al.* (2012) call the investment rule leads to higher debt ratios than the new golden rule. A fundamental aspect of the present debate is uncertainty about the reaction of financial markets to much bigger debt ratios, which is what following their favoured rule would involve. Leaving aside the doubts created by the previous paper I was discussing, let us assume for the time being that higher public net debt does damage growth. The issue that would influence my policy view, probably more than anything else, is the question about how big a cushion economies need in the context of another collapse of the financial sector. The United Kingdom tends to talk about net debt; that was 35.8 per cent (31 March 2007) but has reached 66.2 per cent (31 March 2012), even when “excluding financial interventions” (139.9 per cent with them) (Office for National Statistics, 2012, Table PSF1). So there has been a remarkable increase in UK net debt. My policy instinct is to want as big a cushion as I can possibly have, if you do not have confidence that the financial sector has really changed.

Moving on to Rezk *et al.* (2012) paper, which has two parts. The printer did not work properly but Ernesto very kindly annotated my copy for me, so I could work through it again. The expository part, on the theory, I found very helpful. Some of the things I had read before; some I just did not know. The way it developed successive models, about how human capital might influence growth, was very helpful and I found it very informative.

The second part of the paper is the empirical results and I think there is evidence of haste in the way that these are reported. I found Ernesto's presentation more helpful than the actual paper, in terms of interpretation and of giving me some idea of which of the various results he placed more confidence in. The paper brought home to me the issue of finding good data for human capital. In no sense am I going to criticise the data that have been used, but years of schooling does seem a fairly limited measure. It also emphasises the importance of good social statistics, as well as good economic statistics. If one thinks that there is a complete separation between the social data and the economic data, you can concentrate on securing good economic data. But, as soon as you start arguing that human capital development is important in a growth context, it is very important to emphasise good social statistics and making sure that national statistics and social statistics do not themselves become a casualty of fiscal consolidation.

A final point on issues that came up in the previous papers in this Session of the Workshop. I become very worried about this discussion of "productive" and "non-productive" public expenditure. Hence I very much like the way that the Banque de France paper (Bouthevillain and Dufrénot, 2012), which I am not commenting on, went to the COFOG data. In my own country, when people talk about productive public expenditure, some of what they want to call productive does not strike me as particularly productive at all; some of it is just industrial subsidies. So I think that one has to be careful about the language of productive and non-productive. The more that you stress human capital development, as Ernesto does, the effect that public spending has on human capital may well come from diverse types of spending. This is an important area for research and that research is going to depend on securing better data, as well as protecting existing sources of data.

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