COMMENTS ON SESSION 4
FISCAL TOOLS TO CONTROL MACROECONOMIC RISKS AND IMBALANCES: EXPERIENCES AND PRESCRIPTIONS

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May I thank Daniele Franco and Banca d'Italia staff for a fantastic conference, as is always the case in Perugia. By way of context for my discussion, Scotland is going to have a referendum in 2014 on becoming an independent country and the UK Government tell us that, if we vote "Yes", we will be thrown out of the European Union. In contrast, the United Kingdom will have a referendum in 2017, with the intention – in certain parts of the Government – of leaving the European Union. So discussions about the nature of the European Union and the relationship between the European Union and the Eurozone are obviously of great interest in my country.

I have two papers to discuss. Of the first, by Kastrop, Scheubeand and Hauptmeier (2013), I have only seen the PowerPoint slides; he expanded on them slightly, particularly at the end of his presentation. The other is a fully-fledged paper by Stracca, Buetzer and Jordan on the cultural underpinning of macroeconomic imbalances. What is striking is that the two papers are vastly different in style but they do have links which I will identify. Kastrop promises a formal paper and I look forward to receiving that. There is obviously a limit to what one can say about PowerPoint slides, particularly when one is not sure in advance what will be said in addition. However, the presentation was quite close to the slides.

One of the graphics that people have delighted in showing at this conference is the spread of bond yields across countries in the 2000s, particularly the way in which they were very close together and then diverged dramatically. There is therefore a question about whether the markets did not believe the Eurozone "no bail-out" clause and hence were correct, or whether the markets had misunderstood the relative positions of Eurozone members. Given that Kastrop emphasised the contrast between centralisation of policy functions and a more market-based approach, whether the market got it right or the market got it wrong in that period is an important aspect of the policy background. In his presentation, Kastrop contended that hybrid structures of market-based controls over fiscal policy together with reliance on central authority controls are vulnerable; not necessarily that they would not work but that they are potentially vulnerable.

From a United Kingdom perspective – and potentially from a Scottish perspective – an obvious question is the relationship between the Eurozone countries and the countries that are not in the Euro, either like the United Kingdom (because successive Governments have not wanted to be in) or in the cases of Denmark and Sweden (because their populations cannot be persuaded to go into the Euro). When there is more centralised political authority in the Eurozone, this leaves uncertain the positions of countries which are in the European Union but not in the Eurozone.

There was much emphasis on analogies to existing federations but there is the question of how valid these analogies are. Each of the federal examples has democratic governance, as opposed to technocratic governance or elite-dominated processes. I might be over-influenced by the United Kingdom experience, but one of the things that strikes me as very important is that political elites and business leaders have tended to be in favour of European Union membership yet have been unwilling to make that case forcibly in public. Europe seems to be blamed for everything that goes wrong in the United Kingdom; partly that is driven by xenophobia at the tabloid end of the media. Nevertheless, there is the serious question as to what extent one needs public consent in a

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democracy or whether democracy is a nuisance and one really wants technocrats to run policy insulated from political constraints.

I do not understand what certain terms are now taken to mean, including "fiscal union". If one considers existing federations, there are those such as Australia (which have heavily resourced territorial equalisation systems) at one end of the spectrum and the more competitive federalisms such as the United States at the other. However, people underestimate the sheer size of fiscal transfers in the United States via Medicare, Social Security, the defence budget and various forms of pork-barrel politics in Congress. One of the US fiscal problems is that, although there is a much harder budget constraint at the level of the states, this produces a pro-cyclical bias in fiscal policy which means the Federal Government, though heavily constrained, has to do more fiscal lifting. This further raises the question of the balance between fiscal and monetary policy.

Where Kastrop's presentation differed from the text was on the final slide about the potential role of independent fiscal institutions, arguing that these could be transparency-generating. On this aspect, I am extremely sympathetic (Heald, 2012, 2013), but beyond that you come up against the counter-posing of technocracy against democracy. So independent fiscal institutions that put information into the public domain have my whole-hearted support, but if fiscal policy decisions are to be distanced from democratic politics, there are potentially very serious problems in terms of democratic consent. One of the problems of having technocrats run policy is that questions then arise about accountability mechanisms when technocrats and economists get it wrong (Barber, 2011).

Turning to Stracca *et al.*'s paper, his presentation was immaculate and I really enjoyed listening. He concentrated on the most important aspects of the paper. The written paper is very thorough but that makes it more difficult to focus on the major points. However, I have some concerns.

First, the paper talks about "civic capital" but I do not fully understand the difference between civic capital and the broader notion of social capital. The relationship between these concepts has to be further explored; there is a comment in the paper that they are similar but the relationship is not developed.

Second, the first half of the paper uses values survey data for 65 advanced and emerging countries; I presume that data limitations are affecting which countries are included. The later part of the paper focuses on the Eurozone countries and I will come back to that. The basic argument is that interpersonal trust is beneficial in terms of avoiding macroeconomic imbalances, particularly with respect to the government budget balance and the inflation rate. Though the composite index that the authors use, and do sensitivity tests on, includes the current account balance, that balance itself is less significant. They obtain their data from the World Values Survey and the European Values Survey, and obviously one has to use the data that are available. Some of the questions in those surveys do make me cringe, but there is a plausible argument that, for example, high interpersonal trust reduces transactions cost in the economy. However, empirical work based on these values surveys often ignores intra-country cultural differences. Italy is a good example; even the rest of the world knows that Italy in the North is not the same as Italy in the South. So what does an average value for Italy mean? Italy is perhaps an extreme example, at least in terms of Europe, of having such a well-identified geographical divide; nevertheless this is an important generic issue.

Third, on a more technical level, although Stracca made some reference to this in his presentation, I did not really understand why he was using decade averages. In the presentation he made the point that there is not much year-on-year variation but why should one think that the 1980s, 1990s and 2000s are necessarily an economically significant partitioning of time?

Fourth, I am a Professor of Accountancy and, in the accounting and management research literature, there are persistent references to work done in the 1970s and 1980s by Geert Hofstede, a Dutch management consultant. Now when one goes back to this work, and particularly if one heard Hofstede lecture in the 2000s, some of these characterisations almost feed national caricatures. Yet it remains interesting how his contribution has survived.[1] The economics literature on trust is separate from the Hofstede literature. One of the points that Stracca *et al.* make is that, on some indicators of values, it is not at all obvious what to expect; for example, would one expect obedience to be beneficial to macroeconomic balances or expect religiosity to be positive or negative? Though constraints on available values data are inevitable, there are reasons to exercise caution.

Fifth, the R^2s are not high, at 0.14, but the paper contains a very interesting sentence which Stracca did not use in his presentation. One standard deviation increase in trust corresponds to roughly one half of a standard deviation reduction in macroeconomic imbalances, which is a large effect.

Sixth, Stracca and his colleagues use "quality of institutions" and "confidence in institutions" as control variables. However, if I wanted to explain why Sweden had good economic performance, I would think that the quality of institutions and confidence in them were closely linked to this idea of interpersonal trust. So I would emphasise the sources of interpersonal trust and the channels through which it might work to improve economic performance.

The paper then moves to consider the Eurozone and that is where it becomes denser and rather more difficult to read. One of the conclusions is that cultural heterogeneity within the Eurozone is not particularly large. I wish that the paper had gone from the 65 countries to the European Union before it had moved on to the Eurozone. Given that two of the authors work for the European Central Bank, I can well see why that was done, but it would be very interesting to see the results for the European Union as a whole.

My final question is that, if policy-makers and decision-makers disregard democracy and treat politics as a nuisance, what is likely to be the effect on trust over the long-term? What I would expect is the growth of anti-politics and a flight to extremist political parties. I made the point earlier about the dangers of elite actors being seen to ignore public opinion, without arguing their case. Certainly in the United Kingdom, the trust indicators have gone down sharply. Electoral turnout, which is often regarded as a trust indicator, has fallen, and there is considerable alienation from the mainstream political process. I look forward to receiving Kastrop's paper and I very much enjoyed reading Stracca's paper on culture, though it does not give any easy answers. What I find surprising is the finding that cultural heterogeneity within the Eurozone is not particularly large: this contrasts markedly with much political and media comment since the Eurozone went into crisis after 2008.

[1] For a critique of Hofstede (1980) on culture, see Baskerville (2003).

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