COMMENTS ON SESSION II: PUBLIC DEBT AND FISCAL RULES

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1. An overview

First of all, I would like to thank Daniele Franco for the invitation to this workshop. All the papers included in this session provide a rich and stimulating overview of many of the topics concerning the relationship between public debt and fiscal rules. I would like to congratulate the contributors for their excellent papers. Because of the time constraints, I cannot claim to comment in great detail on all the papers presented. I want to apologize to the authors of the second session whose papers I have not discussed.

In my opinion, this session has included three different sorts of papers. On the one hand, I find two papers focussing on the issue of the effectiveness of the fiscal rules for controlling public debt. I'm referring to the paper by Balassone, Franco and Giordano and to the one by Woods. The first of these contributions tackles a very appropriate question for the fiscal discipline in European Union countries right now: can the financial market mechanisms be an effective alternative to fiscal rules when they have not operated satisfactorily? Later on, I will set my point of view about the implications of this question. In the second paper, Woods introduces an interesting perspective with regard to the debt rules in general and the debt rule in the United Kingdom fiscal framework in particular: their ability to assess the long-term sustainability of the UK's public finances.

On the other hand, two other papers focus on the measurement of public debt and balance on public accounts. Both papers intelligently relate accounting rules with fiscal rules. In their paper, Mink and Rodríguez-Vives provide and compare two measures of government debt in the European Monetary Union from the national accounting framework: ESA95 debt and EDP debt, whereas Boothe analyses in his paper the relationship between the fiscal rules adoption and the choice cash versus accrual accounting regimes.

The last group is made up by three papers. These contributions have got as a common objective to offer econometric analysis aimed at testing different relationships between public debt, budget deficits, interest rates and inflation. In connection with the effects of budget deficits on interest rates, Laubach presents an excellent review of empirical results. The Ber, Brender and Ribon paper analyses how both fiscal and monetary policies can influence short and long-term real yield using data for Israel. Lastly, Faini assesses how fiscal indiscipline among European

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Monetary Union members affects the interest rate on the stock of public debt, emphasizing the relevance of public debt levels and sustainability as explanatory variables.

2. Comments and suggestions

I have read these very interesting and different papers. All of them have given me many suggestions. But it is not easy task to make, at the same time, specific and related comments. I will focus only on some of the most relevant questions. Really, the invisible hand has worked. I have concentrated my comments on the two groups not commented by the other discussant, Sandro Momigliano.

I enjoyed the paper by Balassone, Franco and Giordano. They conjecture whether financial market discipline can provide a fallback solution in case of rule-failure. After ten years of monetary union, everything seems to indicate that the conditions in European financial markets have not changed enough to increase the power of market incentives. However, I agree that the key issue for fiscal discipline is fiscal transparency. Both financial market mechanisms and fiscal rules need to complement each other. Without transparency, I think it is difficult that incentives involved in fiscal rules can become effective. We can see the transparency principle from a double perspective. On the one hand, we advocate transparency in public accounting (debated in Boothe's paper) or in measurement of public debt (debated in Mink and Rodríguez-Vives' paper). On the other hand, we can also claim transparency in financial markets.

But here we find the classical discussion: can the financial market improve itself transparency? My opinion is negative. I think that the fiscal rules should design suitable institutions for enhancing transparency. Here lies their complementary. For instance, the Spanish internal budgetary stability rule has tried to improve transparency through two initiatives: first, creating a new information central agency on regional and local public debt (at the moment, similar functions are carried out by Banco de España); second, redesigning the coordination process for sharing regional and local deficit levels. In both cases, financial market signals seem to have improved, so that the Autonomous Communities with bad public debt indicators have to pay higher interest rates. The question could be: what must the content of fiscal rules be? Numeric rules only or new fiscal institutions as well? My opinion is that to institute fiscal rules is equivalent to design and to put into practice new institutions with their incentives and check and balance mechanisms. Numeric rules are important, but they are only instruments for these institutions, which usually incorporate them as informative signals for fiscal policy management.

Lastly, this paper states explicitly that fiscal discipline can be considered as a public good in federations, with all its allocation problems. I agree with this statement. But this approach gave me an idea. It can be interpreted in a fiscal externalities framework, where the information costs are a determining factor. I think that fiscal federalism literature on vertical and horizontal externalities could provide more arguments (even in an analytical approach) for strengthening the relationship between market mechanisms and fiscal rules. I would like your opinion about this suggestion.

Wood's paper shows an interesting discussion about the UK's fiscal rules used in the implementation of fiscal policy. In particular, he analyses in detail the golden rule and the sustainable investment rule, both considered over the economic cycle. I especially like the section titled "Fiscal sustainability under uncertainty". I think that uncertainty is a crucial matter when we consider fiscal sustainability in a long-term perspective. If I have understood correctly, your risk scenario analysis does not include stochastic and Bayesian considerations. I admit the degree of difficulty to introduce them, but I think that an option could be to include an endogenous indicator of risk. This indicator could be designed estimating a relationship between variability of output gap, variability of real interest rates, and variability of public debt stock.

Finally, I would like to make two comments. The first refers to Boothe's paper. Its content appears to be very clever. We are not faced with a conventional paper on accounting methodology, but with a paper on fiscal institutions performance. Its results can allow us to analyze the fiscal behaviour of EMU members with regard to the Stability and Growth Pact implementation. Since the strategies have adequately been established, I think that an interesting way to develop this paper could be to apply a game theory model. My second comment is about Mink and Rodríguez-Vives' paper. I would like to know how some creative accounting methods applied to public investments (for instance, private financing of motorways or high-speed railways under PPP's methods of payment) could influence public debt measurement.