

COMMENTS ON SESSION 1 NEW METHODOLOGIES FOR ASSESSING FISCAL SUSTAINABILITY

Carine Bouthevillain^{*}

First and foremost, I should like to express my gratitude to Daniele and his colleagues at the Banca d'Italia for allowing me to participate once again in this symposium. Having participated in previous years, I know to what level this symposium is expertly organised, with high quality presentations and exceptionally interesting discussions, both on and off the record.

The two papers that I am going to comment on are both interesting and highly informative and I am delighted to have had the opportunity to examine the subject in great depth at the symposium. The first paper discusses issues of federal fiscal sustainability in the United States (J. Gokhale) and the second concerns projections of the contributory pension expenditure in Spain (J. Gil *et al.*).

These two studies have a number of common features. They both stress the need for long-term fiscal projections when dealing with sustainability issues. They also emphasise the importance of a set of indicators or assessments that could help governments and/or policy-makers to choose a budgetary strategy to curb unsustainable expenditure trends.

However, the two essays follow fundamentally different methodologies with two different objectives:

- the American paper proposes a selection of relevant indicators of sustainability to show the magnitude of the current situation and ways of improving communication to policy-makers. These indicators should serve to show the extent of the deterioration already perceptible and the cost likely to be incurred by delaying corrective structural reforms.
- the Spanish paper uses a detailed micro-simulation model, notably to identify where the increase in pension spending will come from (type of allocation, gender, etc.).

Comments on “Reporting on Federal Fiscal Sustainability in the US” by Jagadeesh Gokhale

For the United States, the main fiscal challenge for the future concerns insurance and welfare system related spending, primarily healthcare expenditure at the federal level. Three categories of public spending related to the welfare system have increased steadily and significantly over the past 40 years: Medicare for the elderly, Medicaid for the poor and Social Security (see Figure 1).

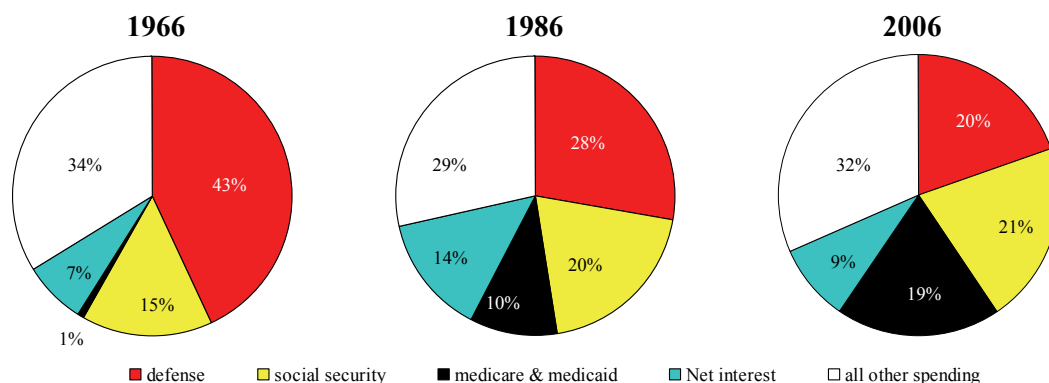
Numerous debates have been held on this issue in economic literature, in official reports from public institutions and upon publication of long-term projections. Forward-looking information presented in these studies shows that the status quo is not sustainable, hence the necessity to examine in detail the sustainability of current policies in order to help the government to draw up and implement new reforms and put pressure on the policy-makers to reverse the current trend as soon as possible.

What are the main contributions and conclusions of Gokhale's paper?

^{*} Banque de France.

Figure 1

Composition of Federal Spending



Sources: Office of Management and Budget and the Department of the Treasury.
 note: Numbers may not add to 100 per cent due to rounding.

First, a number of issues emerge when trying to assess sustainability in the light of its common definition, *i.e.* “future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due”. This definition implies that the resources are obtained in the current legal and political framework.

Gokhale’s paper discusses the difficulty of defining current economic policies and laws. Indeed, a gap often exists between the law as decreed in official texts (*de jure*) and its practical application, or even non-application (*de facto*). Likewise, analysis of trends in public expenditure can reveal certain common practices, notably indexation, without however being controlled by a law.

The other issue highlighted by Gokhale concerns the choice of projection horizon used to measure sustainability. According to the study, calculations predicted to the infinite horizon should take precedence over measures to the finite horizon, which only provide a partial vision of the extent of the fiscal adjustments needed. Furthermore, indicators of cost based both on open and closed groups should be proposed for the principal social security and Medicare expenditures.

The main characteristics of implicit liability indicators, which are not reviewed in the essay, help to clarify the choices made by the author. The following typology constitutes a tool to understanding the concepts used by the author for those unfamiliar with them.

In the closed group, the system (welfare in this case) is immediately closed to new entrants, *i.e.* “accrued-to-date”, or progressively closed to new contributors. The aim is to estimate present pension rights accumulated by *current contributors* by assuming that there are no new entrants in the system and that for those who are already in, the accumulation of rights is stopped immediately or is allowed to continue until the definitive closure of the system, *i.e.* when the youngest contributor becomes a pensioner. This type of estimate measures the magnitude of the system more than its potential imbalances and has proven to be particularly sensitive to the hypotheses of the discount rate that it needs.

In the open group, the calculation takes into account future contributions and benefits paid and received by current and future contributors. This amounts to measuring the sequence of future

deficits or surpluses, in an unchanged legislation context. This category's indicators enable the distance between the current system and a balanced sustainable system (in a steady-state growth context) to be measured. Of these indicators, the three main ones are:

- explicit ex-post debt (simple debt accumulation equation),
- implicit ex-ante debt (level of reserve necessary today to finance future accumulated deficits),
- the tax gap (permanent rise in fiscal revenues to reach a defined target in the future, whether at a finite or infinite horizon).

In view of the number of available indicators and the diversity of the measurements of sustainability that they lead to, Gokhale proposes that, for the benefit of instruction, while preserving a satisfactory level of information, a structured table of key indicators should be presented to the decision-makers in charge of fiscal policies.

This table should notably include:

- information on current and projected fiscal positions at different time horizons,
- closed and open-group cost indicators for major social insurance expenditure, with a greater priority for open-group indicators,
- an assessment of the implicit cost of maintaining current policies unchanged (which amounts to measuring the cost related to delaying the necessary fiscal reforms in order to return to a sustainable situation),
- information on the temporal sequence of future deficits (open group) to guard against the possibility of a balanced infinite horizon liability composed of short-term deficits off-set by long-term surpluses.

In the case of the United States, the tax gap is estimated at 6.7 per cent of the present value of GDP (2008) and the cost of delaying the structural reforms at 7.1 per cent of GDP in 2013. One of the conclusions of this paper is that delaying the reforms would be costly and the sooner adjustment efforts are undertaken the better.

Comparable measurements have been carried out in France concerning pension systems, the area of social welfare that presents the most obvious sustainability risks in the relatively near future. The results are given in Tables 1 and 2 overleaf.

The assessment of sustainability also exists at European level, where the major problem is that of the fiscal costs of an ageing population. The benchmark calculations are carried out by the European Commission's AWG (Ageing Working group). At the level of the European multilateral surveillance system, two sustainability indicators are calculated, S1 and S2, the latter being equivalent to a tax gap, calculated on an infinite horizon but projecting steady-state growth after 2050. *Therefore, experts in both the United States and the European Union consider the same indicator to be relevant.* However, it is clear that this type of indicator does not substitute relatively detailed projections of healthcare and pension expenditure expressed in GDP points, but complements them.

The conclusions reached by Gokhale correspond to a significant extent to work carried out in Europe. Concerns over the issue of sustainability, difficulties related to its measurement and the need to communicate to policy-makers in an informative manner with the aid of relevant indicators are common on both sides of the Atlantic.

My questions concern the clarification of very specific points.

Table 1

French Sustainability Indicators (Pension System Area): Closed-group Approaches
(number of years of GDP in 2005*)

Discount rate	2%	3%	4%
“Accrued-to-date”	4.7	3.9	3.2
Closed group	4.5	3.1	2.1

* High values in the closed group are normal (PAYG system) and do not show evidence of potential imbalances.

Table 2

French Sustainability Indicators (Pension System Area): Open-group Approaches
(percent of GDP)

Hyp: $i = g + 2\%$	2050	Infinite horizon
Explicit <i>ex post</i> debt	100	-
Implicit <i>ex ante</i> debt	41	105
Tax gap	0.8	2.1

- First, while the trigger that distinguishes an “insider” from someone who is not yet in the system is obvious as regards pensions, this is less clear-cut for the areas covered by Medicare and Medicaid. What are the criteria for being included in the closed group (birth, age, contribution, etc.)?
- Although the executive table responds faithfully to the need for synthetic data with a high content of information for specialists, its complexity could constitute an obstacle to its understanding by the general public, or even by the markets. What type of information should be focused on in order to raise private agents’ awareness on the urgent need for fiscal reform?
- It would be interesting, once again for information purposes, to carry out comparative analysis on the costs and benefits of the various reforms that could be carried out to restore the sustainability of the fiscal position. What type of reforms could be favoured in this analysis?
- Lastly, the assessment data presented in the study is not backed up with sensitivity analysis. This is particularly unfortunate since the central hypothesis chosen for the revenue elasticity of health expenditure is very conservative.

Comments on “A Projection Model of the Contributory Pension Expenditure of the Spanish Social Security System” by Joan Gil, Miguel Ángel López-García, Jorge Onrubia, Ció Pextot and Guadalupe Souto

The paper and its presentation are extremely clear and provide detailed information and highly interesting results on the Spanish social security system for pensions.

The approach of this paper is very different from the previous one: it presents a non-behavioural micro-simulation model that allows pensioners' heterogeneity. This method helps us to draw interesting conclusions on the dynamics of expenditure according to pension categories and gender. Moreover, an assessment of projected total expenditure in the long term for pensions may be made via synthetic indicators, although this is not the model's main objective.

The use of micro-data allows the authors to make specific assessments of groups of individuals and thus to draw attention to the finer details of the way the system works.

The method used enables meaningful sensitivity analysis to be carried out using alternative scenarios on productivity, participation rates, demographic changes (or shocks), migration, institutional rules, etc.

The tool is particularly pertinent for the assessment of past or planned reforms and their impact on budgetary imbalances or on the system's features and redistributivity.

While this is not the case for macro-econometric models, for example, the micro-simulation method allows us to assess the impact of past or future reforms, not just generally on the system and on an "average" individual participating in the system, but also on each individual according to specific characteristics. For example, the general analysis will measure the impact of a reform on the average amount of a pension without being able to measure a change in the standard deviation of pensions around that average. Likewise, the impact of a measure that would only affect the basic old-age pension would be misunderstood if it were only analysed at a general level.

To my mind, three of the results presented in the paper are of particular interest:

- First, the assessment of the increase in expenses related to the pension system in Spain seems very robust and widely shared by other work. It is reportedly over 8 per cent of current GDP and is expected to reach close to 16 per cent in 2050, with most of the effect after 2020 principally due to national demographic specificities.
- Sensitivity analyses show that although certain adjustment scenarios produce visible effects on long-term pension spending, none of them are likely to significantly curb the rise expected after 2020.
- Moreover, the model shows that retirement pensions constitute the main component of spending and that a new distribution by pension category or gender is expected by 2050.

This type of work is also significant for its politico-economic implications and aid to decision-making. In France, similar work has been carried out, with the same objective, thanks to the "Destinie" model. Using this model, several simulations have been carried out in order to assess the possible impact of new reforms that aim to make the pension system more sustainable. Amongst the hypotheses that may be tested are the following:

- new rules for the choice of the moment of cessation of activity,
- possibility to cumulate wage and pension for a period of time (progressive retirement),
- rise in the number of years taken into account for the evaluation of pensions,
- rise in the length of the contribution period,
- reduction in the minimum age for retirement with a full pension (long career),
- some pensions could be given on the condition that personal revenues are not very high (survivor's pension),
- change in indexation rules,
- decrease in contribution period for women with children,
- etc.

As for the previous study, the quality of the work presented limits my questions to certain details.

- Though they are not present in the essay, were sensitivity analyses to legislative changes, such as those tested in France with Destinie, carried out/able to be carried out with the Spanish model?
- Can the impact of reforms on other categories of public spending be integrated into the work? I am thinking in particular of the fact that the rise in the participation of women in the labour market could increase public spending related to the home care of elderly people. In this case, the relative decrease in pension sector costs is likely to be offset by a rise in spending in other welfare sectors.
- The gap between the average pension for men and women should be reduced by 2050, from 1.6 to 1.3. These calculations seem to have been based on the current wage distribution for men and women. Should this distribution not be modified to take into account the rise in women entering the labour market and in view of increasingly easier access to higher education for young women?
- Based on the same reasoning, the paper does not provide information on the wage distribution for migrants.
- Lastly, what retirement age has been used in the model: the legal age or the effective age? In France, the gap between these two parameters is significant. What is the case in Spain?

I would like to congratulate once again the authors for their contributions.

I thank you all for your attention.