

COMMENTS ON SESSION 2 SUSTAINABILITY ASSESSMENT AND POLICY IMPLICATIONS

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In their contribution, Anna Kleen and Thomas Pettersson modelled labour supply endogenously in view of ageing populations in order to track structural reforms with the objective of raising long-term potential GDP growth and improving fiscal sustainability. For this reason, they incorporated in their macro equilibrium model a reduction in the tax wedge on labour by more than 8 percentage points (over a 4-year period), matched in the budget in a cyclically-neutral way with curbing public expenditure/social transfers of equal amount. As a result, compared to the baseline scenario, a reduction in the Swedish (currently high) tax ratio by about 5 percentage points would boost Swedish GDP growth by 2 per cent/employment growth by 2.6 per cent until around 2020 and would lower the public debt ratio by 40 per cent of GDP until 2100.

Improving financial incentives is proper to spur economic growth by increasing total hours worked. The results should, however, not be misinterpreted in that a high tax burden creates additional room for budgetary manoeuvre: the key policy challenge in this scenario would be to cut social transfers of an amount equal to the tax revenues foregone. Also the timing of tax benefit reforms is very crucial for the economic and budgetary impact in the short to medium run, as usually different lags will prevail. In addition, due consideration needs to be given to the fact that the reduction in the tax wedge leads to a one-off level shift only, but not to a permanent boost in the long run economic growth rate. Moreover, the uncertainties associated with future potential labour supply hinges substantially on the migration assumptions, *i.e.*, both the actual size of annual migration over a long time-period and the migration features (*inter alia*, age, skills, gender).

Jérôme Creel and Francesco Saraceno concluded in their paper that an increase of public services/public investment may stimulate economic growth when the increase in productivity outpaces negative consumption effects. However, this outcome is subject to a level of overall public spending (G) which is not excessively high and that (public) capital spending is effective, *i.e.*, corresponding at least to market returns. They also stated that in this context some delay in the tax adjustment to the new public spending level is justified, as the inter-temporal budgetary constraint will permanently be respected.

In this scenario, the definition of the public spending threshold, where the marginal costs of taxation exceed the marginal benefits of public spending, is key. Given an already fairly high spending level in many European countries, this model, at first glance, appears to be applicable only to a limited degree. Public spending is based on a mere input concept where G is an monotonously positive exogenous productive input to capital, thereby neglecting the possibility of hump-shaped curves in their impact on economic growth/ productivity, as usually assumed in the literature on QPF. Hence, the QPF issue of efficiency and effectiveness of public spending does not play any major role in this concept. Furthermore, while arguing in favour of temporary deficit financing of additional public spending, issues of time consistency of fiscal policy need to be accounted for as well.

Roel Beetsma and Heikki Oksanen presented a model of actuarial debt neutrality, which is determined by the current generation's paying for the present value of future equal benefits plus the interest for past incurred public debt. In political terms, this would mean a definition of

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intergenerational equity by fixing total debt given an unchanged retirement age. In this paper this will result in an – implicit plus explicit – debt level of 288.5 per cent of GDP, which does not readily appear to represent a sustainable fiscal starting point. European PAYG systems would, thus, need significant budgetary surpluses (with an estimate of 1.6 per cent of GDP on average) in order to respect actuarial debt neutrality. In that sense, the current MTOs of the SGP do not seem to be ambitious enough, while at the same time the deficit ceiling of 3 per cent of GDP punishes systemic funded pension reforms which are presumed to support considerably actuarial debt neutrality.

As in many generational accounting models, the results are very sensitive to interest changes, resulting in huge shifts in public debt accumulation, and would ignore severe long run impacts on capital markets, which make it very difficult in defining essentially (actuarial) policies. The key issue is, however, in this definition of intergenerational equity whether the total pension benefits accrued over lifetime, depending on the current generosity level and the duration of benefits, is sustainable from the outset. At the same time, this concept is very far away from regular budgetary cash management which would make its application for policy makers even harder. Moreover, while a sound funding of pension entitlements is truly needed, it is highly questionable whether one should allow a systemic switch from a PAYG to a fully funded (private) system to be completely exempt from the SGP (in contrast to granting a very limited exception to the 3 per cent rule, as it is now foreseen). Sizeable temporary costs for the budgets would not be reflected on appropriately. It is noteworthy in this regard that the SGP has a focus on short and medium-term stability issues.