COMMENTS ON SESSION 4
ENVIRONMENTAL ISSUES AND SUSTAINABILITY REPORTING
IN THE POLICY DEBATE

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Academics like us understand that the share of our populations who are elderly is growing and is about to expand dramatically, potentially raising all kinds of fiscal havoc if governments do not act soon. Yet, at least in my country, policymakers have yet to "bite the bullet". Social Security, and the much more immediate and severe problem of Medicare, are still the "third rail" of American national politics. Indeed, financing Medicare at its current level of benefits will very likely not be feasible, even under the most favorable of economic conditions and with a politically plausible increase in taxes. When American baby boomers like me get too old to work, we probably will have to accept less medical care unless we pay for it out of our own pockets.

So, why are U.S. policymakers so unwilling to act? The short-sightedness of their constituents? Higher immediate priorities, such as national security, propping up a crumbling financial system, providing short-term fiscal stimulus to a shrinking economy? All of these factors are relevant. However, according to Rafael Domenech and Angel Melguizo, the political paralysis, both in the U.S. and other nations, stems in part from widespread misunderstanding of the nature and depth of the problem. The papers by Domenech and Melguizo, and that by David Hauner, Daniel Leigh, and Michael Skaarup (the two papers I have been asked to discuss) provide analyses that dispel much of the haze surrounding these issues.

Both papers clearly parse the problem in ways that gives policymakers a clear picture of the principal factors that will determine the extent of nations' future fiscal sustainability problems emanating from demographic changes. In so doing, they provide insights into the policy levers that could be used to mitigate the severity of future tradeoffs that these changes will necessitate. The papers also identify and quantify the impact of factors largely outside of policymakers' control.

Both sets of authors stress the uncertainty inherent in forecasting future fiscal imbalances. It is not easy for most policymakers and their constituents to think in probabilistic terms. When confronted with warnings of future problems, they generally want an estimate of "the size of the problem". Economists like us (and perhaps gamblers in Las Vegas and Monte Carlo) understand that a range of potential scenarios could play out. This is an important insight that policymakers should appreciate. It is important because, if understanding of uncertainty is widespread, policymakers are compelled to reveal their aversion to risk. They need to appreciate that if they craft solutions projected to achieve sustainability under the *most likely* scenario, they still leave their nations exposed to substantial fiscal risk. As Hauner, Leigh, and Skaarup put it:

> *"Overall, the uncertainty surrounding long-term expenditure projections suggests that fiscal policy should not rely on baseline projects alone but also recognize the upside risks to these projections….more attention should be paid to 'worse case' scenarios".*

Being risk averse, I would prefer to "over solve" problems entailing future fiscal sustainability. I would rather sacrifice more today to increase the probability that my children and grandchildren will have a fiscally secure tomorrow, even if in doing so my "promised" age-related benefits will have to be cut. (So far, as a generation, we baby boomers, at least in the United States,

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have taken the opposite tack, consuming and making commitments today in a way that will seriously constrain the resources and choices available to our progeny). By making a variety of projections, whose underlying assumptions range widely from the optimistic to the pessimistic, the authors of both papers challenge the policymaker making use of their analyses to reveal just how much they are willing to sacrifice in the near term to increase the chance that both the elderly and future generations of non-elderly will be provided for.

Domenech and Melguizo state another reason for getting policymakers, and the public at large, more familiar with “confidence intervals” surrounding projections. They argue that policymakers tend to dismiss the severity of the problem when base case projections prove to be way off the mark. By stressing the uncertainty of projections, policymakers can less easily justify putting these long-run demographic time bombs on the back burner.

Domenech and Melguizo project future scenarios for one country, Spain. They do a very nice job of parsing the determinants of the problem into the path of future economic and demographic trends (such as labor productivity the dependency ratio), and variables reflecting policy choices (such as the extent of the coverage of the pension system and the percentage of the elderly who actually claim pensions). The authors proceed to project 27 different scenarios, built on the possible combinations derivable from three alterative assumptions for each of three sets of variables: socio-economic, demographic and institutional. For each scenario they project public expenditure and the balance in public pension funding as a share of GDP out to 2060. Their exercise demonstrates that, with so many determinants, a wide range of necessary increases in the ratio of public expenditure to GDP are plausible – all substantial increases, nonetheless.

Demenech and Melguizo use the aggregate accounting approach, eschewing general equilibrium analysis in the interests of greater simplicity and, therefore, greater transparency of results. By contrast, Hauner, Leigh, and Skaarup perform a dynamic analysis, using the IMF’s Global Fiscal Model to analyze who various policy adjustments to achieve fiscal sustainability affect macro economies. The three authors highlight the range of possible scenarios and key underlying determinants in two ways. First, they perform a cross-country analysis using the G-7 countries. Second, they test the sensitivity of their results to a few underlying assumptions, such as the interest rate, rates of change in age related costs, and alternative fiscal sustainability targets. One of their more interesting findings, in my opinion, is the significant roles that a country’s current fiscal position and debt ratio play in determining the extent of adjustment necessary to achieve fiscal sustainability.

Domenech and Melguizo strongly urge academics to make the substantial breakthroughs in analysis of fiscal sustainability accessible to policymakers. In a similar vein, Hauner, Leigh, and Skaarup call for, and deliver, a “harmonized set of fiscal indicators to compare fiscal sustainability across all G-7 countries. While both of these papers provide a wealth of policy insights neither, understandably, is written in a manner that most policymakers or their advisors could easily understand. (After all, these pieces were written for this workshop, not as white papers for legislators or chief executives).

Yet, the challenge of bridging the gap between academics and policymakers must be met. I have been heartened by the support expressed by many presenters at this workshop for greater efforts to clarify issues of fiscal sustainability for policymakers.

The goal of providing objective, high-quality, timely communicated, and clearly communicated policy analysis to policymakers, reporters, and thought leaders on a wide variety of issues is the paramount mission of the New England Public Policy Center at the Federal Reserve Bank of Boston. It is a difficult goal to achieve.

In order to achieve it we must do at least two things: 1) write at a level understandable to someone with no training in economics whatsoever, and 2) "sell" our analysis, much like a lobbyist tries to persuade policymakers to adapt a particular set of laws or regulations for the interests that he or she represents. Lucid objective policy analysis is a political resource. As such, some officials will try to curtail its dissemination and/or distort its content for their own purposes. Consequently, simply writing "good stuff" is insufficient. We must be in persistent contact with those in power, or their advisors, to discern what problems they are considering, what questions they need answered, and when they need them to be answered. Too often, policy analysts possessing the analytical tools to pierce the fog surrounding a complex topic issue their reports to the public, suggesting that these are important issues that policymakers should be thinking about. The more effective approach to improve policymaking is, instead, to ask policymakers (or reporters), "What's on your mind? What questions do you need answered and when? How can we be of service to you? (with the understanding that the only answers they get will be objective, fact-driven ones)"

Most policymakers, at some time (but not all the times), want an unbiased, clear analysis of issues. But they want to digest it on their terms; they do not want to be lectured by some academic. In some parts of my country there is a strong latent anti-intellectual bias, especially at the sub-national governmental level. In these circles, intellectuals are to be toyed with or even ridiculed, not listened to. If we are to succeed at helping policymakers to make more informed decisions, on issues of fiscal sustainability or other issues, we must be politically savvy – "street smart at the street level".

An example of the kind of effort I have in mind is that the Peter G. Peterson Foundation is currently undertaking. The Foundation's explicit vision is "to keep America strong and the American dream alive by promoting responsibility and accountability today to create more opportunity tomorrow." Among other initiatives the foundation has made a movie, "I.O.U.S.A." which is being shown in scores of U.S. cities, at universities and in other venues. The Foundation has launched a virtual crusade to make people aware of issues of fiscal sustainability, enlisting articulate speakers from across the political spectrum all of whom agree about the magnitude and urgency of the problem, even if they disagree on the mix of solutions.[1]

[1] For more on this foundation's work, see its website, http://www.pgpf.org