The EU Stability and Growth Pact and INTIMO: some preliminary comments

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The national budget should be balanced...
the treasury should be refilled ...
public debt should be reduced ...

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What is the Stability and Growth Pact (SGP)

A set of fiscal rules for EU Member States: a permanent constraint on fiscal policy, expressed in terms of a summary indicator of fiscal performance, such as the government budget deficit, debt, or a major component thereof.

Why?

Originally created to confer credibility to the process towards the single currency (Maastricht Treaty) and to force the Member States to have sound finances as high levels of debt produce negative externalities particularly on inflation (moral hazard).

Why?

In 1997, new rules were specified and the SGP was adopted to establish a fiscal policy discipline so that each country should be able to respond to asymmetric shocks while moral hazard behaviour is prevented.

The SGP main rules

- In the medium term, the public budget should be *close* to balance and the ratio debt over GDP should be less than 60%.
- Excessive deficits must be avoided: the ratio deficit/GDP must be under 3%.
- Excessive Deficit Procedures (EDP) may be opened if a Member State does not respect the parameters.

Here we focus on the public deficit:

- To understand the definition of this variable
- To find a “place” for this variable in our model
- To find the necessary data set
- To connect INTIMO with the new System of Institutional Accounts

The definition of public deficit for Excessive Deficit Procedure (EDP)

- “Government deficit (surplus)” means the net borrowing (net lending) of the sector of “general government” (S.13, as defined in ESA95).

- This definition has been strongly influenced by the original Protocol annexed to the Maastricht Treaty (1992) and therefore with reference to the ESA79.

The definition of public deficit for Excessive Deficit Procedure (EDP)

- More recently, new regulations have amended ESA95 to record swaps and forward rate agreements (FRAs) as financial transactions rather than interests.
- Furthermore, Eurostat decided to treat generally the allocation of mobile phone licenses as the sale of non-financial asset.

$\Downarrow$

These two decisions have caused the ESA95 deficit to diverge from the EDP deficit.

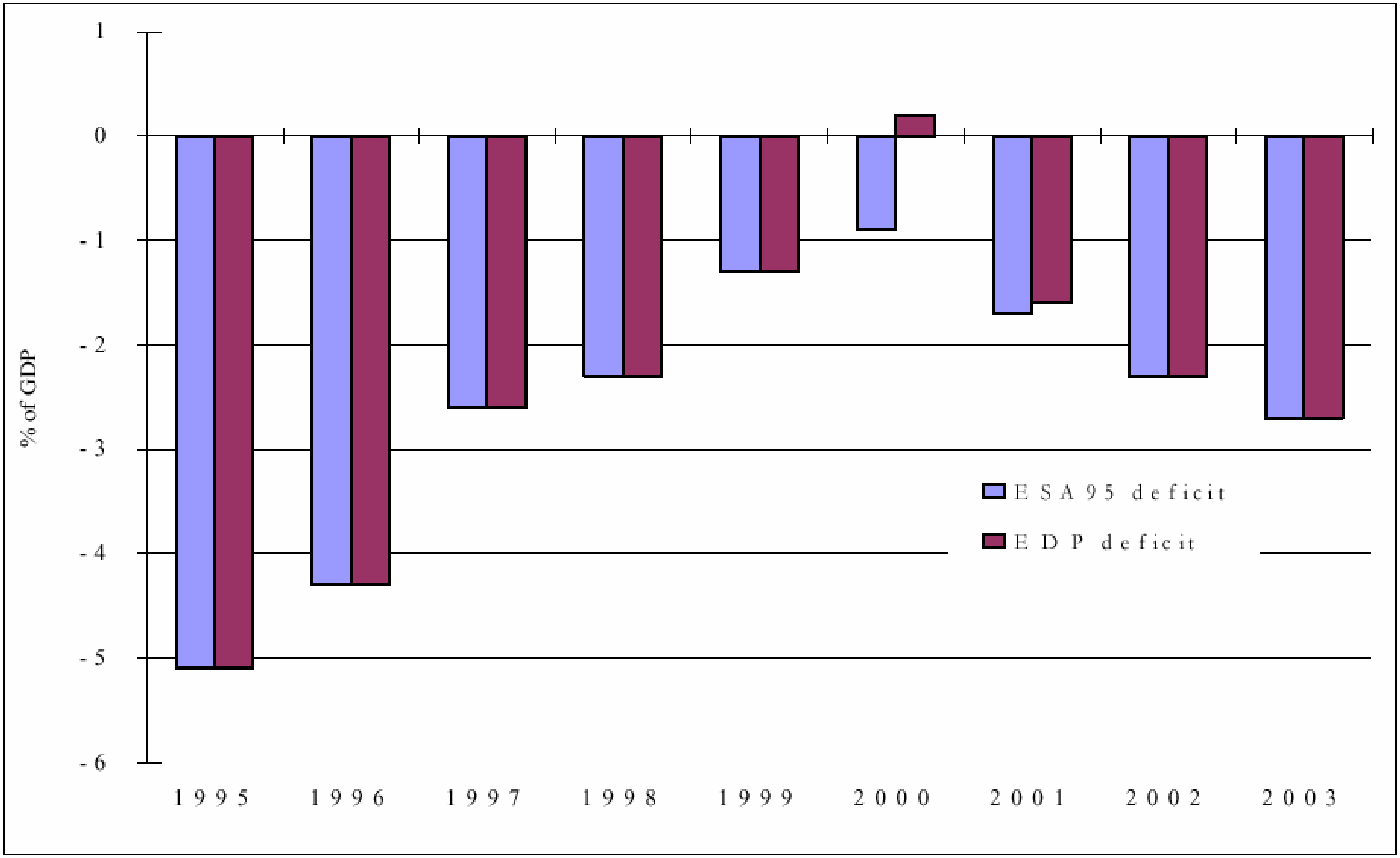
ESA95 and EDP government deficits

ESA95 deficit (-)/surplus (+) (B.9) (net lending (-)/net borrowing (+) of the capital account)
+ Property income received from net settlements paid under swaps and FRAs
= EDP deficit (-)/surplus (+) (EDP B.9)

In addition to the property income, the one-off effects due to the sale of UMTS licenses has been included in EDP deficit figures.

ESA95 and EDP government deficit

euro area, as a percentage of GDP



Some problems with the government accounts

In recent years, starting from 2001, a variety of changes in the definition and composition of these variables has taken place due to:

- the uncertain classification criteria for financial transactions
- restructuring of the government units implying their reclassification outside the sector S.13
- other fiscal gimmicks to improve the fiscal balance.

Therefore, government accounts are subject to several revisions after notification by each country to EU as Eurostat must validate the data: last May Eurostat revised the Italian data for the years 2000-2004.

- National data on deficit and debt must be trasmitted twice a year (March and September).
- In Italy, ISTAT compiles the government economic accounts (the balance item is net lending/borrowing) while the Bank of Italy compiles the financial accounts and the stock of public debt.

The government economic accounts: two formats

1. These data are compiled in a very detailed format with a sequence of sub-accounts (as part of the Institutional Accounts, ESA95).
2. An alternative and more popular format – at least in Italy –is given by the consolidated government account.

A scheme of ESA95 institutional accounts

Table 8.1 Synoptic presentation of the accounts, balancing items and main aggregates

	Accounts								Balancing items		Main aggregates
	Full sequence of accounts for institutional sectors										
Current accounts	I.	Production account	I.	Production account					B.1	Value added	Domestic product (GDP/NDP)
	II.	Distribution and use of income accounts	II.1.	Primary distribution of income accounts	II.1.1.	Generation of income account			B.2 B.3	Operating surplus Mixed income	
					II.1.2.	Allocation of primary income account	II.1.2.1.	Entrepreneurial income account	B.4	Entrepreneurial income	
							II.1.2.2.	Allocation of other primary income account	B.5	Balance of primary incomes	National income (GNI,NNI)
			II.2.	Secondary distribution of income account					B.6	Disposable income	National disposable income
			II.3.	Redistribution of income in kind account					B.7	Adjusted disposable income	
			II.4.	Use of income account	II.4.1.	Use of disposable income account			B.8	Saving	National saving
					II.4.2.	Use of adjusted disposable income account					
Accumulation accounts	III.	Accumulation accounts	III.1.	Capital account	III.1.1.	Change in net worth due to saving and capital transfers account			B.10.1	Changes in net worth, due to saving and capital transfers	
					III.1.2.	Acquisition of non financial assets account			B.9	Net lending/Net borrowing	

The consolidated government account

ITALY - Government Consolidated economic account (March 2005)

Millions Euro

ITEMS	2001	2002	2003	2004
USES				
Government consumption	229.518	238.921	253.035	260.063
compensation of employees	*131.084*	*136.423*	*143.870*	*148.248*
intermediate consumption	*62.338*	*63.411*	*66.978*	*66.755*
social transfers in kind via market producers	*31.299*	*33.084*	*33.909*	*36.302*
Social benefits	202.291	214.035	224.445	234.181
Other current expenditures	29.611	31.139	34.662	35.907
Current Expenditures (net of interests)	461.420	484.095	512.142	530.151
Interest paid	79.570	72.547	69.275	67.911
Total current expenditures	540.990	556.642	581.417	598.062
Gross fixed investments	30.196	23.768	34.133	34.875
Investment contributions	15.688	17.914	18.129	16.717
Other capital expenditures	5.582	5.852	5.244	3.572
Total capital expenditures	51.466	47.534	57.506	55.164
Total expenditures	592.456	604.176	638.923	653.226
RESOURCES				
Direct Taxes	182.690	178.964	178.098	184.175
Indirect Taxes	176.492	185.116	187.345	195.207
Actual Social contributions	149.841	157.504	165.101	171.198
Imputed social contributions	3.978	3.737	3.798	3.558
Other current revenue	40.090	40.613	40.617	44.055
Total current revenue	553.091	565.934	574.959	598.193
Capital Taxes	1.065	2.986	21.926	10.721
Other capital revenue	2.337	2.600	4.246	3.435
Total capital revenue	3.402	5.586	26.172	14.156
Total revenue	556.493	571.520	601.131	612.349
Net lending (+)/Net Borrowing (-)	-35.963	-32.656	-37.792	-40.877
Primary deficit (-)/surplus (+)	43.607	39.891	31.483	27.034

Our goal

- To get this information as an output of INTIMO because this is the main reference account for economic policy and planning, for the SGP and, in general, for macroeconomic analysis of the public sector.

How?

- The road has been already shown by Almon (INFORUM Conference in Poland, 1995) and Grassini (INFORUM Conference in Spain, 1998).

The main idea

- The new Institutional Accounts (ESA95) can be used to update the Accountant of INTIMO and, besides, a quarterly model for Italy.
- Some items of the Accounts can be obtained from the IO model. Others can be modelled by “behavioural proportions” or specific equations or taken as exogenous/policy variables.

First steps

- We have updated the existing quarterly Italian model data bank with the new system of Institutional Accounts (ESA95): much more variables than in the ESA79 system.
- We are in the process of updating the accountant side of INTIMO.

Problems so far ...

- The data from the available Institutional Accounts for Government (February 2005) are not consistent with the Government Consolidated Account from which they *should* be derived: the balancing item (net borrowing) is different.

- Thus, we are checking all items to find the possible reasons:

1. the different definition of government deficit (ESA95 and EDP);
2. the different timing of revision;
3. some additional information used for the consolidated account;
4. statistical error.

From the Government Accounts to the Consolidated Account

USES		RESOURCES	
CFNp	**Government Consumption**	**RLGp**	**Gross operating surplus**
- rldUp	Compensation of employees	**ineEp**	**Interest received**
- coiUi	Intermediate consumption	**iipEp**	**In direct taxes (received)**
	Social transfers in kind		
- ammUp	Depreciation	**irpEp- irpUp**	**Direct taxes (consolidated)**
- iipUp	In direct Taxes (paid)		
- RNGp	Net operating surplus		
	Market output, output for own final use and other sales		
copUp	**Subsidies**	**cseEp**	**Actual social contributions**
prsUp	**Social Benefits**	**csfEp**	**Imputed social contributions**
taiUp	**Current Transfers to private social institutions**	**aicEp**	**Current International cooperation**
aicUp	**Current International cooperation**	**tcdEp**	**Miscellaneous current transfers**
tcdUp	**Miscellaneous current transfers**	**rpsEp+ terEp+ divEp+ iadEp**	**Other current revenue**
terUp + pnaUp	**Other current expenditures**		
Sum of items in bold	**Current Expenditures (net of interest payments)**		
ineUp	**Interest paid**		
	Total current expenditures	**Sum of previous items**	**Total current revenue**
IFLp+ antUp	**Gross fixed capital**	**iccEp**	**Capital taxes**
caiUp	**Investment subsidies**	caiEp	**Investment subsidies**
tccUp	**Other capital transfers**	tccEp	**Other capital transfers**
IFLp+ antUp+ caiUp+ tccUp	**Total capital expenditures**	**iccEp+ caiEp+ tccEp**	**Total capital revenue**
Current expenditures +capital expenditures	**Total expenditures**	**Current revenue + capital revenue**	**Total revenue**