Comments

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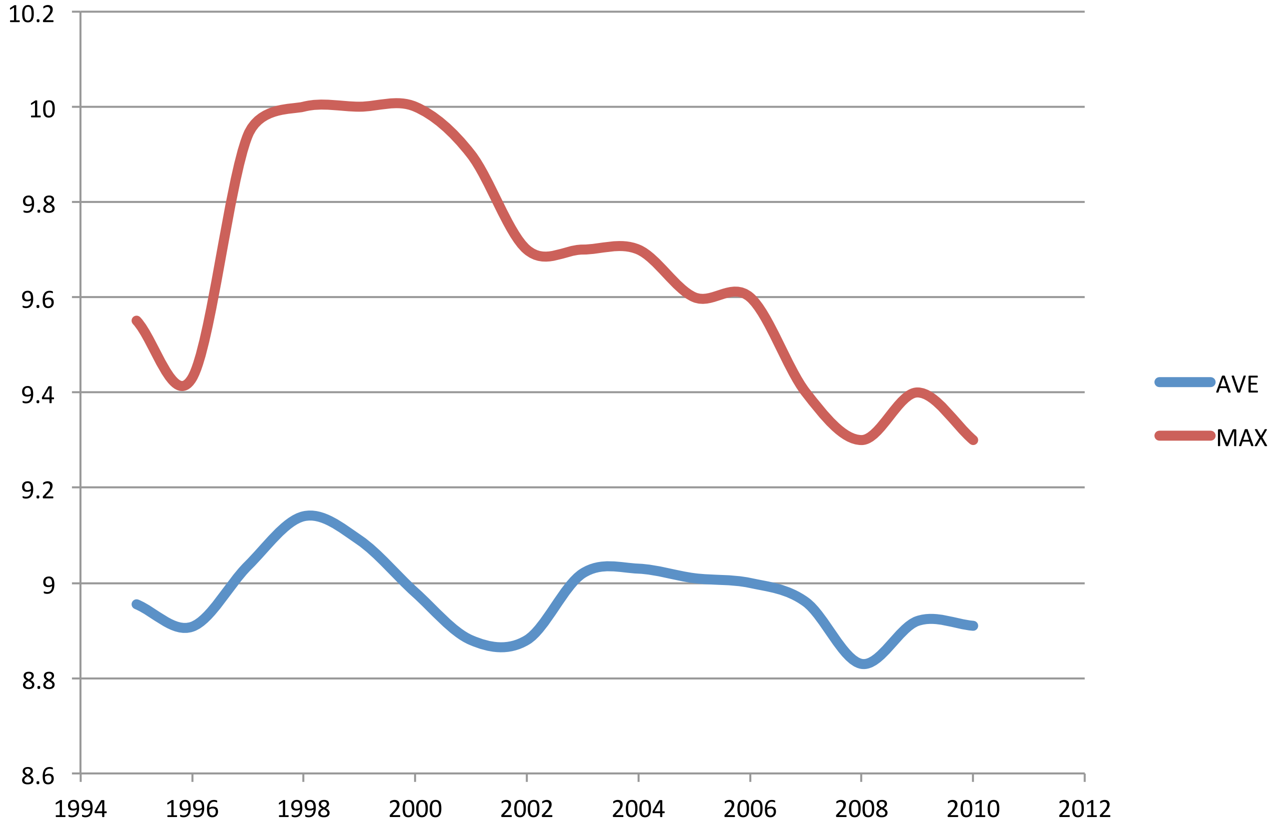
Topics

- Demand for transparency and accountability.
- Why isn't market discipline enough?
- On measurements of fiscal sustainability.
- Role for fiscal councils.

Demand for transparency and accountability 1

- Accountability may have deteriorated over the past 20 years: The TI corruption **perception** index (the higher the score, the less perceived corruption, AVE = Average score of 1995 top 10 countries, MAX = annual maximum score):

TI Corruption Perception Index



Demand for transparency and accountability 2

- Does this reflect only citizens' concern over the public sector fiscal sustainability?
- There are other explanations:
  - Overall economic situation, crises, bank bail-outs.
  - Globalization: how to evaluate own policy makers when the society is influenced by events not in their control?

Market discipline a solution to the accountability problem? 1

- In general, why should the accountability to only one segment of the global society, global financial markets, satisfy the demand for accountability by citizens in individual nations?
- Changing attitude by the Finnish policy makers and policy making machinery? Stability and Growth Pact (MofF supported because market discipline was regarded weak) versus eurobonds (MofF against as claimed to blur market signals)?

Market discipline a solution to the accountability problem? 2

- Market discipline may be the problem:
  - Self-fulfilling crises: Expectations of crisis in public finances may make default less costly to policy makers.
  - Contagion: Current crisi/es vs Asian crisis.
  - Moral hazard by banks: Bail-outs and excess profits earned on crisis country debts. Implications for accountability.

Market discipline a solution to the accountability problem? 3

- Market discipline and political biases:
    - Markets favor, in addition to reducing indebtedness, certain policies over others:
    - Market discipline may increase political polarization and thereby incentives of the political system to increase debt.
    - May change the strategic incentives to use debt: easier for conservatives to use debt for binding future governments to reduce public spending, incentives for left wing governments to reduce (income) taxes and fiscal stringency.
    - Markets thus may worsen the deficit bias.

Market discipline a solution to the accountability problem? 4

- Current crisis is not a public debt crisis but the continuation of the financial market crisis since 2008.
- Finland end 2007: MofF estimate of the ”sustainability” deficit 2 billion euros, now (end 2010) 6,5 billions. As sustainability deficit calculations are based on factors not changing rapidly, can one take the difference between the two, 4,5 billion euros as one metric of costs of the financial crisis to people of Finland? Or something wrong in calculations? Or measure of (in)competence of the previous government?
- EU/EMU has been transformed from a union basically handing just subsidies to agriculture to a union handing subsidies to both agriculture and owners of private financial institutions.

On measuring financial sustainability 1

- Measures of the need for public sector adjustment do not take into account some prioritized, apparently recurrent expenditures.
- The most important ones are the implicit commitments to the financial sector, bail-outs seem to be hear to stay..
- The system now promises almost full bail-out to the private financial institutions. The size of these promises should be estimated and included in the sustainability calculations to put them on the same level playing field as other expenditures.
- Budget surpluses are defended as buffers against future crises.
- These buffers must be given explicit numbers and added to expenditures with explanations on how they are expected to be spent (bail-outs?) to allow discussion on policies to reduce these expenditures.

On measuring financial sustainability 2

- Sustainability calculations usually do not include proper treatment of uncertainties etc..
- The calculations do not shed any light on the policies needed to correct the situation nor their timing.

On fiscal councils 1

- In Finland all policies are based on consensus based work where buraucrats act as mediators, giving them a public image of impartiality.
- The Finnish policy-making environment has been more hostile towards proper policy evaluation than in other Nordic countries (though the atmosphere seems tobe improving)

On fiscal councils 2

- There would be an inherent conflict between the council and the bureaucracy. E.g. The Finnish Tax Reform Working Group from which all academic experts were excluded, and e.g. person with very thin research background from a NGO lobbying heavily for income tax reductions appointed.
- Supply side constraints: The number of economics professors in Finland is the same as in the Econ Dept at University of Copenhagen: Hard to see how fiscal council could be manned without hurting the activities of departments; very few academics specializing in macroeconomics.
- Accountability improved by shifting to a system where policy design responsibility is given to explicitly politically nominated heads of the ministries, each government appointing its own?