

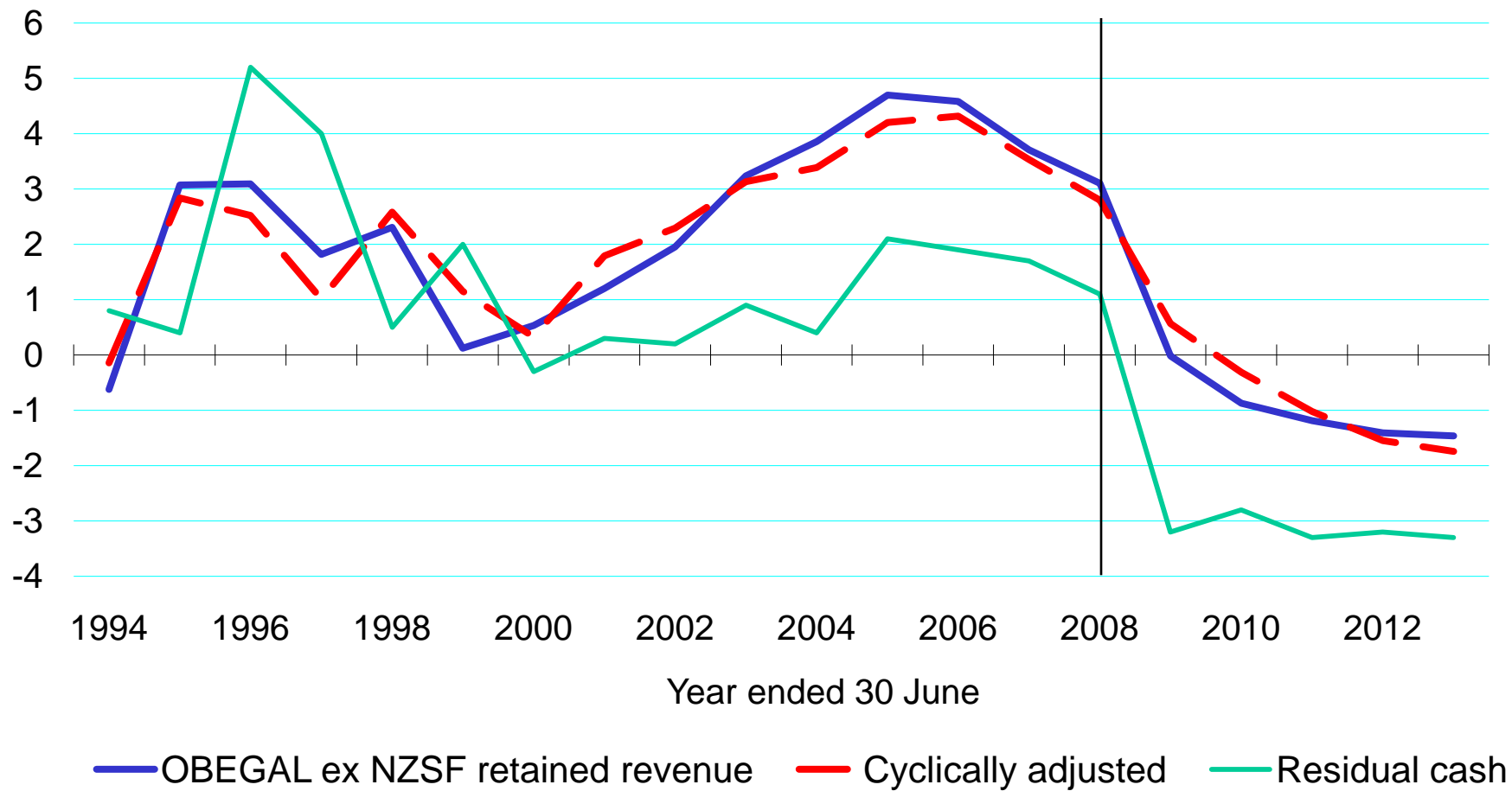
EU membership and the stationarity of budget deficits

Holmes, Otero and Panagiotidis

*Workshop on Monetary and Fiscal Policy Interaction
9 October 2008*

Comments by John Janssen
New Zealand Treasury

Fiscal balances (% of GDP)



Source: The Treasury



Statistical tests and the IBC

- IBC: current debt = sum of expected future discounted primary surpluses
- Empirical studies of budget deficit behaviour concerned with violation of IBC based on underlying stability of past data processes
- Bohn (2007): error-correction interpretation as a reaction function where the correction term (α) is a policy choice variable



Other approaches

- Paper argues that stationarity of budget deficits is of interest in its own right given Maastricht and Stability and Growth Pact (SGP) limits
- But can a richer story be generated by looking at fiscal policy shocks and interactions with other variables in a VAR framework? Dungey & Fry; OECD; Kim, Tam & Buckle (2001) on *ex ante* targets



Results

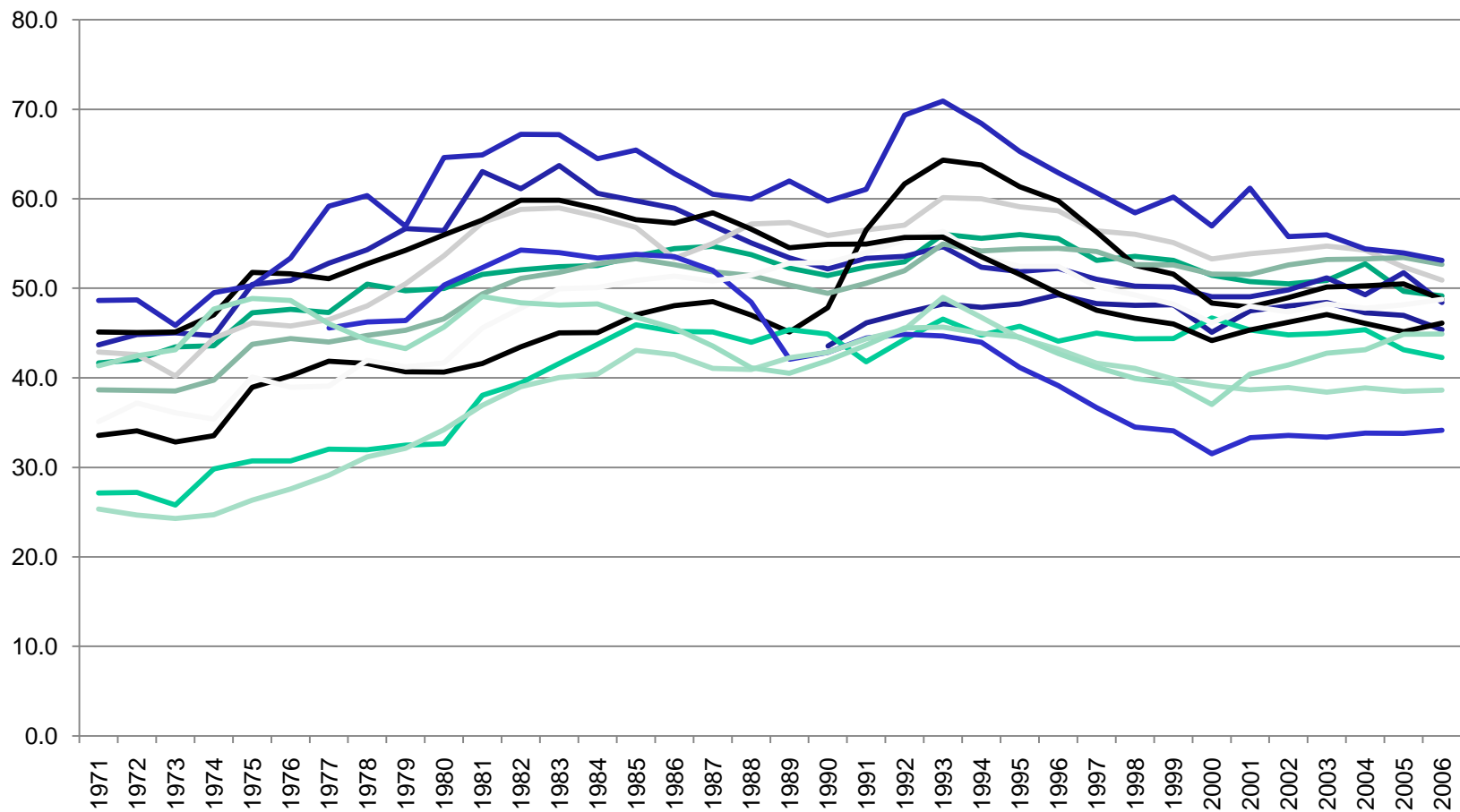
- Model 0 (with a constant) over 2 subsamples for Maastricht and German unification
- Qualitatively similar results with intercept and trend – interpretation?
- Single country tests unclear
- Panel tests (with bootstrap) and unknown breaks – fail to find evidence of non-stationarity regardless of single currency



Questions and issues

- Which deficit? EU debate around current/operating balance (golden rule): Blanchard & Giavazzi (2004); Fatás (2005)
- Does adjustment via T or G matter?
- Do “good times” or “bad times” matter?
- Adjustments around changing ratios of T and G relative to GDP – do levels and structures play a role?

General government outlays (% of GDP)



Source: OECD



More questions and issues

- Real time fiscal analysis and information available to decision makers (Mohr and Morris, 2007; Bernoth, Hallet and Lewis, 2008): output gap revision = errors in fiscal surveillance; pro-cyclicality arises with *ex post* data
- Longer-term projections (European Commission and others) – fiscal future is different to the past



New Zealand context

- Treasury's first statement on the long-term fiscal position (2006)
- Pensions and health
- No business cycles
- Unconstrained scenarios where primary deficits grow (and IBC not satisfied)
- Top-down constrained scenarios where taxes and/or spending adjust