Statistics and Lampposts: For Support or For Illumination? [1, 2]

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For communication purposes, politicians and policy makers often prefer simple and unambiguous messages. Statistical indicators seem to be able to provide such clarity. A government deficit of more than 3% of GDP is "bad", a government deficit is less than 3% is "good". Government debt of more than 60% of GDP: bad! Less than 60%: good! The economic reality, however, is often more ambiguous and less clear cut than what can be derived from single headline indicators. Even worse, in some cases, indicators may actually harm appropriate evidence based decision making. The paper will provide some examples from practice, and will look at ways and opportunities to address this problematic situation. What can be done in terms of communicating about statistics? What can be done to improve the statistical literacy of politicians and policy makers/advisors? What, more generally speaking, can be done so that statistics are used for illumination instead of for support?

Key words: indicators, government finance, evidence based policy making

1. Introduction

1. The use of certain national accounts indicators, like government deficit and debt, for rather specific purposes of monitoring, is a prime example of a more general tendency to use national accounts data for so-called "administrative purposes". Another example concerns the use of Gross National Income (GNI) to determine a country's contribution to the budget of international organisations. This type of use of statistical data has become more and more widespread, most prominently within the European Union, and tends to put special (political) attention on certain parts of the national accounts framework, with clear advantages and disadvantages as a consequence.

2. The special focus on certain national accounts aggregates has clearly resulted in an improvement of the relevant indicators in terms of their reliability and their international comparability. It has also brought to the fore the importance of having adequate statistics for evidence based policy making. On the other hand however, there are also potentially negative consequences. Looking at the focus on the two headline indicators on government finance, while it may provide a single and clear message on the status of public finances within the EU to the politicians and the public at large, it has also created great incentives to governments to compile figures on deficit and debt that look good, instead of them being good from an economic substance point of view. There is a clear tendency to continuously look for "grey areas" to manipulate the relevant national accounts data, in order to stay within the stipulated deficit and debt limits. These practices have substantially increased in "popularity" since the start of the financial crisis during which significant pressures on government finance emerged, amongst others by the direct and indirect effects of the economic downturn and the bailouts of banks.

3. In relation to government deficit and (gross) debt, one can additionally question the appropriateness of the two relevant headline indicators. From a conceptual point of view, other indicators may provide a much better picture of the status of government finance. That being said,

[1] This short paper should not be reported as representing the official views of the OECD or of its member countries. The opinions expressed and arguments employed are those of the author.
[2] This paper is a short summary of a working paper presented at the 2013 OECD Working Party on Financial Statistics: Isabelle Ynesta, Peter van de Ven, Eun Jung Kim and Catherine Girodet: "Government Finance Indicators: Truth and Myth" (COM/STD/DAF(2013)16).

more generally, one can question the almost exclusive focus on the two headline indicators, as they will always provide a partial and somewhat one-dimensional picture, not telling the whole story. In this respect, one can observe a certain unwillingness to look beyond the relevant indicators, politicians and policy makers alike "simply" using the indicators for support of their predetermined goals. One can also observe a certain unwillingness of statisticians to use alternative and/or additional indicators which may actually provide a better picture of the economic situation. To paraphrase Andrew Lang: "The relevant statistics are being used as a drunken man uses lamp-posts - for support rather than for illumination".

4. This paper will discuss the example of the EU Excessive Deficit Procedure (EDP) to shed some light, in section 2, on the advantages and disadvantages of the "administrative use" of statistics for monitoring purposes. Section 3 will then look at ways and opportunities to address this problematic situation. What can be done in terms of communicating about statistics? What can be done to improve the statistical literacy of politicians and policy makers/advisors? What, more generally speaking, can be done so that statistics are used for illumination rather than for support?

2. Advantages and disadvantages of using statistics for "administrative purposes"

5. As stated in the introduction, the use of statistics for administrative purposes has clear advantages and disadvantages. In addition to making politics and the public at large more aware of the fact that statistics are important and do matter, it has clearly improved the quality of the relevant statistics, in terms of reliability, international comparability and transparency. As a consequence of the political and/or financial emphasis on the relevant indicators, a number of controls and procedures have increasingly been developed to ensure that the relevant data are calculated according to high quality standards. Looking at the Excessive Deficit Procedure, a whole body of jurisprudence has been developed on the appropriate and consistent interpretation of the international standards. To arrive at this more detailed interpretation of the standards, procedures have been put in place, involving preparations by specific Task Forces, formal advice from the Committee on Monetary, Financial and Balance of Payments statistics (CMFB), a decision by Eurostat, and finally inclusion in the Manual on Government Deficit and Debt (see http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-13-001/EN/KS-RA-13-001-EN.PDF). Furthermore, in response to misreporting by the Greek authorities, the legal possibilities of Eurostat to monitor the appropriateness of the estimates have been extended, for example by allowing for in-depth "methodological visits" and having admittance to the underlying administrative records of a national government's bookkeeping system. Nowadays, the EU also has explicit law to prosecute statisticians for deliberate misreporting.

6. In addition to having improved the quality of the relevant statistics, the focus on certain headline indicators, as in the case of government deficit and debt, also brings a single and clear message on general government finance to politicians, financial market analysts and government policy economists as well as the public at large. Because of their comprehensiveness, they are continuously cited in the media, and used in economic policy debates and financial market analysis, in addition to their original monitoring purposes. However, being so clear, simple and straightforward, they also bear the danger of over-simplifying the status of government finance. They will always remain, by their nature, one-dimensional.

7. Because of the political sensitivity and the related focus on the two indicators, one can also observe unwanted side-effects on the compilation practices, by way of the development of fiscal gimmickries to embellish government accounts. Here, reference is not made to deliberate misreporting, which is simply to be considered as a form of fraud[3]. Usually, creative accounting

[3] The prime example of course relates to Greece; see e.g. the report of the European Commission published in early 2010: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/COM_2010_REPORT_GREEK/EN/COM_2010_REPORT_GREEK-EN.PDF.

relates to measures that do improve either government deficit or debt, according to the EDP definitions, but which – looking at it from an economic substance point of view – do not improve the financial situation of government finance as such. A typical example concerns the recording of a particular deficit or transaction increasing the public debt within a public corporation's balance sheet, the corporation not being part of general government. Another example relates to the recording of a capital injection as a financial transaction, not affecting government deficit, instead of recording it as a capital transfer. The classification of such capital injections as either or not impacting on government deficit became very relevant during the economic and financial crisis, when several governments had to intervene into the banking system. In response, more precise rules were formulated, according to which these capital injections could only be recorded as the purchase of financial assets, if the expected future return on these investments was in line with the thresholds of the European Commission's State Aid rules[4]. The "explosion" of Public-Private-Partnerships (PPPs) can also be looked upon as a phenomenon that is at least partly related to this type of creative accounting. A final example concerns the sale and lease back of non-financial assets.

8. Creative accounting may also concern the search for "grey areas". In this respect, one has to realise that how exact and precise the standards and definitions may be, there is always room for interpretation, or perhaps better, for misinterpretation. This continuous search for "grey areas" has led to a vast amount of additional guidance and rules, which are laid down in the EU Manual on Government Deficit and Debt[5]. The most prominent example of this relates to the recording of the assumption of pension obligations towards employees of public corporations by government. In 1996, France Telecom made a huge one-time payment to the government and in return the government took over the responsibility for the relevant pension obligations. After a long and tense discussion, it was decided to record the payment to government as a capital transfer, thereby improving deficit (and debt). However, this decision was based on a rather "technical" and "procedural" interpretation of the ESA 1995 standards, and one clearly had the feeling that other than content-related arguments have fed into the process. From an economic substance point of view, government simply received cash in return for taking over a liability, clearly a purely financial transaction, not having an impact on government deficit. Moreover, the cash transfer enabled the government to diminish or increase to a lesser extent its gross debt, as future pension obligations are not included in the EDP-definition of government debt. Anyhow, the decision enabled France to meet the 3% threshold, it accounted for almost half of France's deficit reduction in 1997 (0.5% of GDP). Subsequently, many EU-countries copied the French "trick": Belgium, in 2003, with the transfer of Belgacom pension liabilities; Portugal, in 2010, with the transfer of Portugal Telecom Communiçaoes pension fund obligations, etc.

9. Another example relates to the recording of government interventions into the banking sector which also led to the creation of new entities, the so-called "*financial defeasance structures*". The aim of such units was to manage the "non-performing" assets of distressed institutions and restore the profitability of the transferring bank. Some of these structures were majority owned by private banks, which raised quite some discussion on the allocation of such units to either the government sector or the financial sector, thus potentially having a substantial impact or not on general government debt. In short, the CMFB advice was to disregard the formal ownership structure, and to look at the economic substance, boiling down to who takes the decisions, and who guarantees and pays for eventual losses. If government is the one, then the structure should be consolidated within the government. Notwithstanding this advice, Eurostat, in its decision of July 2009, set up rules according to which, under certain restrictive conditions, these types of unit could be classified outside government, on the basis of its majority private ownership. With the introduction of the ownership criteria for the sector classification, similar rescue units are nowadays treated in quite different ways. It may also be clear

[4] See http://ec.europa.eu/competition/state_aid/overview/.
[5] See http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-RA-13-001/EN/KS-RA-13-001-EN.PDF.

that the rules based on formal ownership criteria make it relatively easy to manipulate the organisation of the defeasance structure in such a way that it can be excluded from the government accounts.

10. Another potential disadvantage of the “administrative use” of national accounts data is that it also gives impetus to what could be described as being “exactly wrong instead of being approximately right”. In some cases, one becomes more inclined to be against the application of a concept that, from an economic substance point of view, is to be preferred, because it may create some problems related to the precise measurement of the relevant concept or definition. A recent example relates to the discussion on the definition of gross debt for EDP purposes, more specifically to whether or not to include “other accounts payable” into the definition. From a conceptual point of view, this would clearly be preferable. Yet, quite a number of countries expressed their doubts because of the difficulty to arrive at a high-quality, internationally comparable measures for this item. However, even in the case of lower quality estimates, one could argue that international comparability of gross debt as a measure of indebtedness of a country’s government would be enhanced by including other accounts payable. Related to this is the more general concern of political interference, implicit or explicit, into the process of defining and interpreting international standards for the compilation of national accounts.

11. Notwithstanding the undisputable increase in the quality of the indicators that are used for “administrative purposes”, one can also observe that, when it comes to the allocation of human and financial resources, priority is given to those parts of national accounts that are relevant for the administrative use of data, simply because of its political importance and the risk of possible mis-measurement, as a consequence of which one can notice a decreased inclination to look at other demands, more related to general economic policy and economic research.

12. Finally, the use of certain headline indicators may drive less adequate government policy. In the case of the EDP in Europe, an example relates to the pension reforms, in the late 1990s and early 2000s, in Poland, Hungary and other Central and Eastern countries, in response to pressures from growing pension benefits due to the aging population. In addition to the public first pillar (Pay-As-You-Go system – PAYG), these countries introduced a private, pre-funded, defined contribution second pillar pension system. To finance this change, the relevant countries redirected part of the social contributions to the new system, with a higher government deficit and debt[6] as a consequence. To relieve countries for part of the pressure of the pension reforms on government deficits, it was decided at some stage that for EDP purposes, countries could adjust their deficits for the full amount in the first year, gradually decreasing to zero after a period of five years. However, the pressure on government deficits from these reforms is of course far more long lasting, and with quickly growing deficits and debt levels as a consequence of the economic and financial crisis, Poland and other emerging European countries engaged in the reform of their pension systems could not conform to the Stability and Growth Pact (SGP) fiscal limits. This did not provide an equal treatment compared to countries with similar PAYG-systems who did not engage in reforms (e.g., France, Germany, Italy, Portugal and Spain), and whose deficits and debt levels may be lower at the moment, but forecasted to increase in the coming years while facing growing pension benefits as part of their PAYG-systems. In 2010, the reformers requested from the European Council (EC) a full adjustment of the EDP thresholds to accommodate the impact on pension reforms. In the absence of a suitable response from the European Commission, the reformers decided to stop or reduce the contributions to the second pillar pension system, to improve the level of their deficit and debt. Even more far-reaching, Hungary redirected all contributions to the first pillar pension system by stopping mandatory contributions to the private system and by strongly encouraging pensioners to also redirect their pension assets to the public system. In May 2011, Poland reduced contributions from 7.3% to 2.3% of wages to cut back its

[6] In this respect, it should be noted that EDP government debt does not include (the lowering impact of the pension reforms on) pension obligations of government.

deficit. As a consequence, the reformers did not have time to experience any benefits of a pre-funded pension system.

13. The main problem is related to the recording of PAYG systems according to the international standards for the compilation of national accounts, and the related EDP-definitions of government deficit and debt. PAYG-systems are not recorded on a full accruals basis, according to which the contributions (and the compensation of employees) should equal the growth in future pension entitlements through a year's employment, and the increase in pension entitlements are directly recognised in the balance sheets. If that were the case, and gross debt were adjusted accordingly, there would have been a level playing field and a more appropriate recording of fiscal sustainability, without giving incentives to less favourable policies from an economic point of view, just because of its "positive" impact on the deficit and debt, as presently defined. When discussing the recently revised standards for national accounts, SNA 2008 and ESA 2010, the recording of the PAYG systems was extensively discussed. However, an agreement could not be reached, and a compromise was reached allowing countries some "flexibility" in the recording of the relevant government sponsored schemes. In addition, however, it was also agreed that, outside the core system of national accounts, additional data will have to be provided showing pension entitlements arising from all pension systems. Within the EU, it has been agreed that such data will be provided on a three years basis, starting in 2017.

14. Another example of potentially driving less adequate policy is related to the fact that government deficit includes the expenditures on investments, such as those related to electricity, telecommunication, transport (public infrastructure), education, public health, environmental protection, military defence, research and development, etc. As a consequence, spending on public investments has a negative impact on government deficit (and debt). On the other hand however, it is well documented by economic research that public investments stimulate economic growth and generally have a positive impact on productivity in the private sector. Both from a business cycle point of view and for reasons of structural economic policy, one could therefore argue that governments preferably should try to maintain expenditures on public investments, in order to generate future income and restore long-term growth. However, due to the economic and financial crisis, and the subsequent pressures and almost exclusive focus on government deficit and debt, a majority of countries have been lowering their gross capital formation since 2009. In addition, it is clear that, within the EU, public investments are especially beneficial for the Central and Eastern European countries (CEECs) for which the development of public infrastructure can help them to reach the level of economic development of other EU members. In fact, stimulated by the CEEC's joining the EU in 2003-2004, public investment of CEECs has grown strongly. Unfortunately, due to the economic and financial crisis, governments had to choose between encouraging further infrastructure development and minimising the deficit. In the end, most governments decided to reduce their investment expenditures.

3. What can be done to address the situation?

15. In the above, the main pros and cons of emphasising on a few headline indicators for the analysis of government finance have been briefly addressed. Perhaps, the single most important message coming from this analysis is that an almost exclusive focus on the two headline indicators, government deficit and (gross) debt, may indeed provide a single and clear message for communication purposes, but that it also provides a (very) partial view on government finance and sustainability, and may even give rise to less adequate policy decisions. The use of these indicators is further hampered by the continuous search by countries for "grey areas" in the standards and related fiscal gimmickries to embellish the results, as a consequence of the political importance and political sensitivity of the indicators, mainly but not solely in the European Union.

16. To start with, one has to recognise the limitations of the present headline indicators, other indicators actually being more appropriate for the goals that are generally pursued. This calls for a clear communication about the limitations of the present indicators, and for a more active publication and communication of alternative indicators, if not to replace than to add to the present indicators. One can argue, for example, that for various reasons net saving and net financial debt (or net worth) are to be preferred. In the case of debt, for the time being, one may need to focus on net financial debt, instead of net worth, mainly because of issues related to the non-availability and the lack of international comparability of data on non-financial assets. The latter obviously calls for the improvement of data on non-financial assets of general government, allowing for the compilation of full balance sheets, and thus the computation of net worth, for government. Having more details on assets and liabilities broken down by instrument and by counterparty sector (especially the distinction between domestic sectors and the rest of the world) would also be helpful to analysing the financial situation of government. Having data on the public sector, i.e. general government *plus* public corporations majority owned by government, would be a following step in having a more complete picture. Several initiatives are underway to improve the situation in this respect.

17. Another very important piece of information that needs to be enhanced, especially in view of the ageing societies, concerns the measurement of explicit and implicit pension liabilities. A full accrual accounting of government sponsored pension systems, including the measurement of the related pension obligations, should be envisioned. At the moment, many of these obligations are not recognised in the core system of national accounts. In this respect, the completion of table 17.10 of the SNA 2008, and thus the provision of additional information on the non-recognised pension obligations of government, would significantly enhance the analysis of government finance. Within the EU, it has already been decided that table 29 in the ESA Transmission Programme (the equivalence of SNA table 17.10) has to be provided every three years on a mandatory basis, starting in 2017.

18. More generally, a better information base on contingent liabilities would help to assess a government's vulnerabilities to outward shocks. Momentarily, the international standards for national accounts generally do not record contingent liabilities (and assets) in the balance sheets. However, data on such contingencies may provide valuable information to analyse public finances of a country. A typical example of contingent liabilities is the guarantee schemes provided by governments to secure bank liabilities. During the economic and financial crisis, governments supported the financial sector by providing guarantees to secure inter-bank lending and debt issued by financial defeasance structures. During the period 2008-2010, guarantees issued by euro area governments amounted to 6.5% of GDP. Greece granted guarantees amounting to 25.1% of GDP in order to maintain the stability of the Greek banking system. As a response to the above mentioned challenges and in order to get a more complete picture of government finance, Eurostat already decided in 2013 to introduce a supplement to the existing EDP questionnaires to be collected once annually in December. This supplement consists of three tables:

- Table 1 on government guarantees;
- Table 2 on off balance sheet Public Private Partnerships; and
- Table 3 on non-performing loans.

Also in other forums, discussion is taken place on extending the collection of relevant contingent liabilities.

19. As a final note to this paper, I would like to emphasise again the inherent limitations of focussing on certain headline indicators, also of the alternative indicators proposed in this paper. Intrinsically, such headline indicators always provide a one-dimensional view on the rather complex economic phenomenon of financial sustainability of government finance. Consequently, it is desirable to calculate and publish more indicators on government finance, together with the headline indicators. It is also considered of the upmost importance to provide adequate written context to the indicators. The goal should be to provide illumination, and not just support to a particular policy perspective.