David Backus <david.backus@gmail.com>

(no subject)

Pescatori, Andrea <APescatori@imf.org> Wed, Jan 2, 2013 at 1:14 PM
To: "david.backus@gmail.com" <david.backus@gmail.com>
Cc: "Helbling, Thomas F." <THELBLING@imf.org>, "Kose, Ayhan" <AKose@imf.org>, "Asdorian, Gavin" <GAsdorian@imf.org>, "Abiad, Abdul de Guia" <AAbiad@imf.org>, "Duttagupta, Rupa" <RDuttaGupta@imf.org>, "Kuan, Toh T." <TKUAN@imf.org>, "Simon, John Albert" <JSimon@imf.org>, "Sandri, Damiano" <DSandri@imf.org>

Dear Prof. Backus,

Following your question to Ayhan "*… I've been trying to reconcile data on government deficits with data on government debt, and they don't line up. WEO is an example, but the same is true of all the sources I've tried ….* " please find below our reply.

In principle, the change in the net debt of a country should be equal to the country's deficit—i.e., the *net lending/borrowing requirement.* However, this is rarely the case leading to the so called stock-flow adjustment between (net) debt and deficits.

This adjustment arises for different reasons, including valuation effects through the impact of exchange rate changes on foreign-currency denominated debt, time-of-recording effects (deficits are often measured in accrual terms while debt is a cash concept), and below-the-line operations such as privatization and transactions in financial assets. While some stock-flow adjustments are to be expected due to accounting issues, large and persistent stock-flow adjustments could be the result of inappropriate recording of budgetary operations and, if positive, could lead to ex post upward revisions of deficit levels.

More generally, another important thing to bear in mind is that gross debt includes financial transactions. The difference between gross and net debt data provides a measure of the magnitude of these below-the-line transactions, since government assets are netted from liabilities when compiling net debt data. For example countries may accumulate financial

assets to invest budget surpluses instead of paying back debt: say a country with a $100 surplus (stemming from tax revenues being higher than spending) acquires $100 worth of equity shares or financial derivative products. The net debt is clearly left unchanged. The *net lending*, however, is equal to $100 since equity shares and financial derivatives are <u>not</u> included in the definition leading to a stock-flow adjustment of $100.

Econometric analysis also suggests that for the advanced economies over 1980–2010, in addition to the net accumulation of financial assets, fiscal costs arising from banking crises significantly contributed to stock-flow adjustments. In emerging and low-income economies, on the other hand, banking crises, valuation effects—primarily, changes

in the domestic currency value of the public debt stock arising from exchange rate fluctuations—and debt forgiveness or reduction were the main determinants of stock-flow adjustments. For the low-income economies, in fact, the larger number of negative cumulative stock-flow adjustments compared to the advanced and emerging economies is mainly the result of debt relief and forgiveness.

Finally, it has been suggested that greater fiscal transparency reduces the stock-flow observed adjustment, however, the evidence within AEs is not very strong (see Seiferling 2013 and Weber 2011)

Please find attached the appendix 4 of September 2011 Fiscal Monitor which explains some of the concepts and a forthcoming WP on fiscal transparency.

Best Regards,

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More technically, *lending/borrowing requirement* can be measured identically as the balancing item in either the capital or financial accounts (see OECD National account at glance 2009)

1) It can therefore be derived as saving less acquisitions plus disposals of non-produced non-financial assets plus capital transfers receivable minus gross capital formation minus capital transfers payable.

2) Or it can be derived as the difference between net acquisition of financial assets and net incurrence of liabilities. Financial assets (and liabilities) include: Monetary gold, Special Drawing Rights, Currency and Deposits, Securities, Shares and other equity, Insurance Technical Reserves (including net equity of households in pension funds, see Sections 5, 7 and 8) and Other accounts receivable and payable (such as trade credits and advances for work in progress or to be undertaken).

The first definition is the one adopted by current statistical standards (see GFSM 2001 4.15). Unfortunately, the two definitions are rarely exactly the same.

Additional reference: Anke Weber, 2012. "**Stock-Flow Adjustments and Fiscal Transparency: A Cross-Country Comparison**,"IMF Working Papers 12/39, International Monetary Fund.

2 attachments

Stock-flow A4 Fiscal Monitor Sept 2011.pdf
764K

IMF_Working_Paper_-_Stock_Flow_Adjustments_and_Fiscal_Transparency_01_13.DOCX
168K