Discussion: ‘are there policy alternatives to Ireland’s austerity?’

Response to Stephen Kinsella (University of Limerick)

by Neil Lancastle

(University of Leicester)

Overview

- An outline of the paper
- The data are problematic
- The structural model/SFC method

What is the SFC approach?

‘The only point I would wish to make is that, as you will quickly realise, the thing is to a very large extent an exercise in accountancy – or perhaps logic is a more congenial word’

Wynne Godley to J.K. Galbraith, personal correspondence, 24 January 1983

An outline of the paper

- A five sector model: financial, non-financial, households, government, rest of the world
- The central bank is part of the financial sector
- Households consume out of current and past disposable income
- ROW demands deposits, loans and equities... and supplies bonds
- Model is estimated using OLS with two distinct loan regimes (pre-2007 and post-2007)
- Taxes and spending are shocked
- Future work will produce an SVAR of the Irish economy

Model estimation requires good data

(S-I) = (G-T) + (X-M)

Private sector surplus = deficit spending + current account surplus

*The private sector surplus is a **net** position:*
Change in foreign ownership of domestic assets – change in domestic ownership of foreign assets

CAB + CAP + FAC + ORT = 0

Where CAB is the current account balance (goods, services and net investment income); CAP is the balance on the capital account; FAC is the balance on the financial account; and ORT are the official reserve assets

Category issues and data gaps:

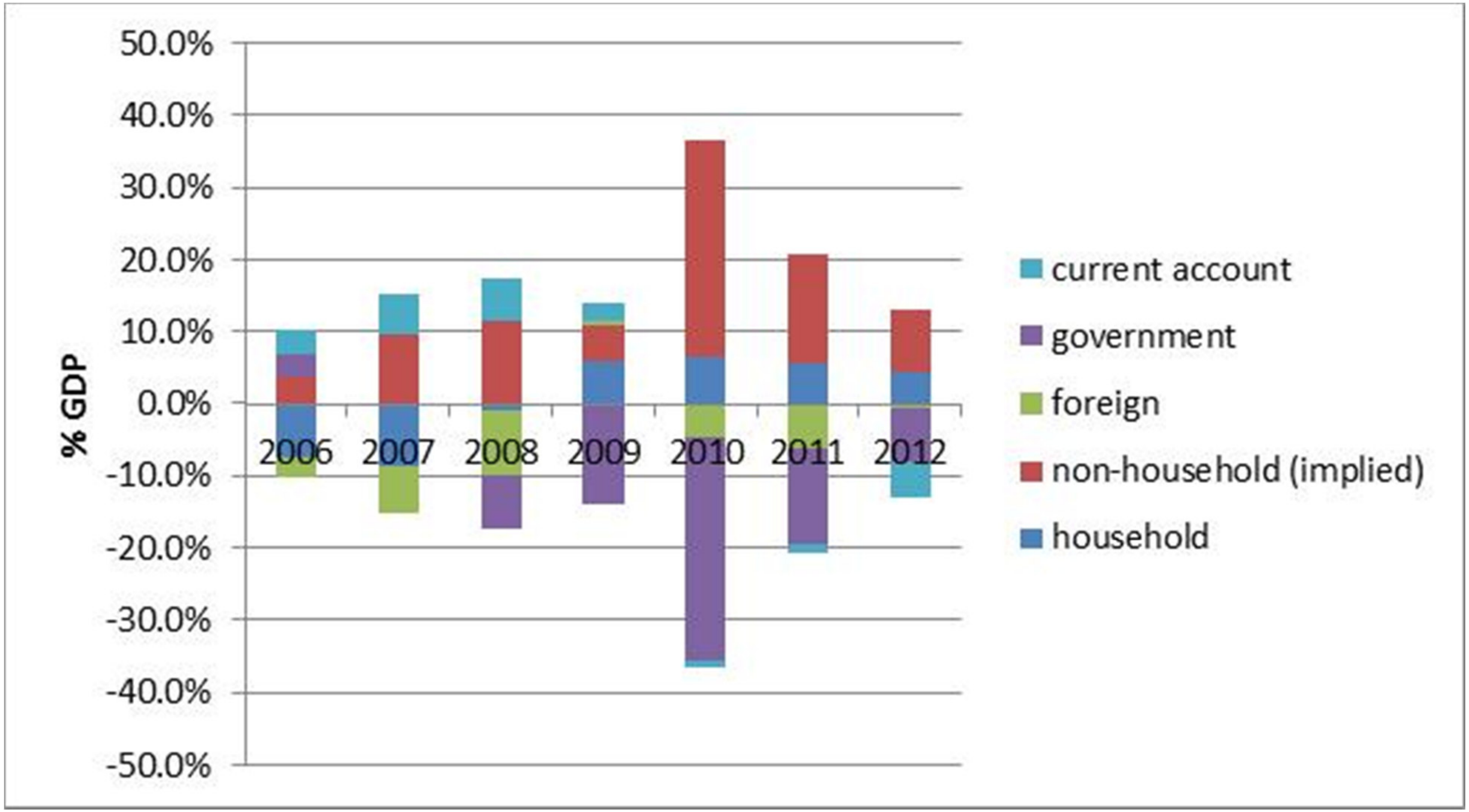
‘Flows denominated in a foreign currency are converted to their value in the domestic currency at the rate prevailing when the flows take place, and positions are converted at the rate prevailing on the balance sheet date’ (IMF, Balance of Payments Manual, 6th Edition, 2009, p. 45)

Irish subsidiaries of foreign companies; duration mismatches; transfer payments to avoid US tax; booking onshore revenue offshore

Gross flows matter

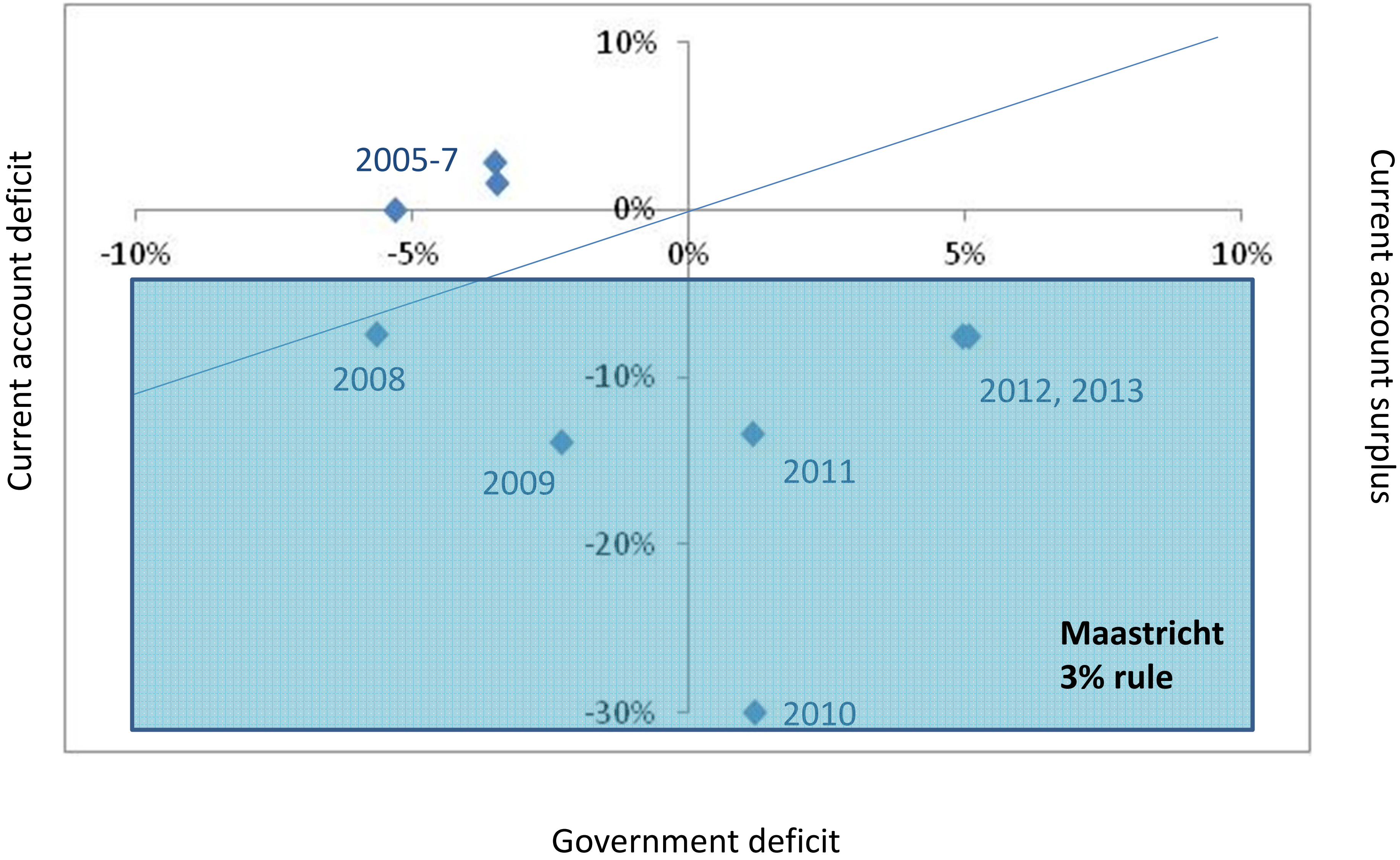
Country	Ireland							
Sector	S2: Rest of the world							
Measure	C: National currency, current prices, millions							
Frequency	Annual							
Period	2005	2006	2007	2008	2009	2010	2011	2012
Transaction								
B9F: Net financial transactions	-486	4770	12049	16135	-1063	7279	10076	987
FAS: Net acquisition of financial assets	346470	373795	361975	167208	-29579	52726	14752	17706
F2AS: Currency and deposits	81341	90141	124639	118086	-91360	-71270	-85451	-97839
F3AS: Securities other than shares	114431	106390	74596	13764	2419	-32946	-4250	4643
F4AS: Loans	55963	18561	47343	21201	19880	6962	98765	13496
F5AS: Shares and other equity	79576	130935	107385	11633	41394	123860	26039	83254
F6AS: Insurance technical reserves	11943	16861	18502	-7834	12615	5988	-19731	-1468
F7AS: Other accounts receivable	3210	10916	-10486	10348	-14535	20092	-682	15628
FLI: Net incurrence of liabilities	346956	369025	349926	151073	-28516	45447	4676	16719
F2LI: Currency and deposits	34780	54532	69652	15213	-24837	-5253	41723	-34678
F3LI: Securities other than shares	71300	147431	156088	54181	-25777	-21123	6629	58551
F4LI: Loans	162365	42463	85287	75848	-10091	20061	-24206	-49549
F5LI: Shares and other equity	66456	121198	27803	13352	32500	43870	-8003	33247
F6LI: Insurance technical reserves	3105	-670	7376	1034	3925	-886	-16487	-1892
F7LI: Other accounts payable	8950	4071	3720	-8555	-4236	8778	5020	11040

Major shifts in financial behaviour



Foreign surplus as deposits and equity | Foreign surplus as loans and equity

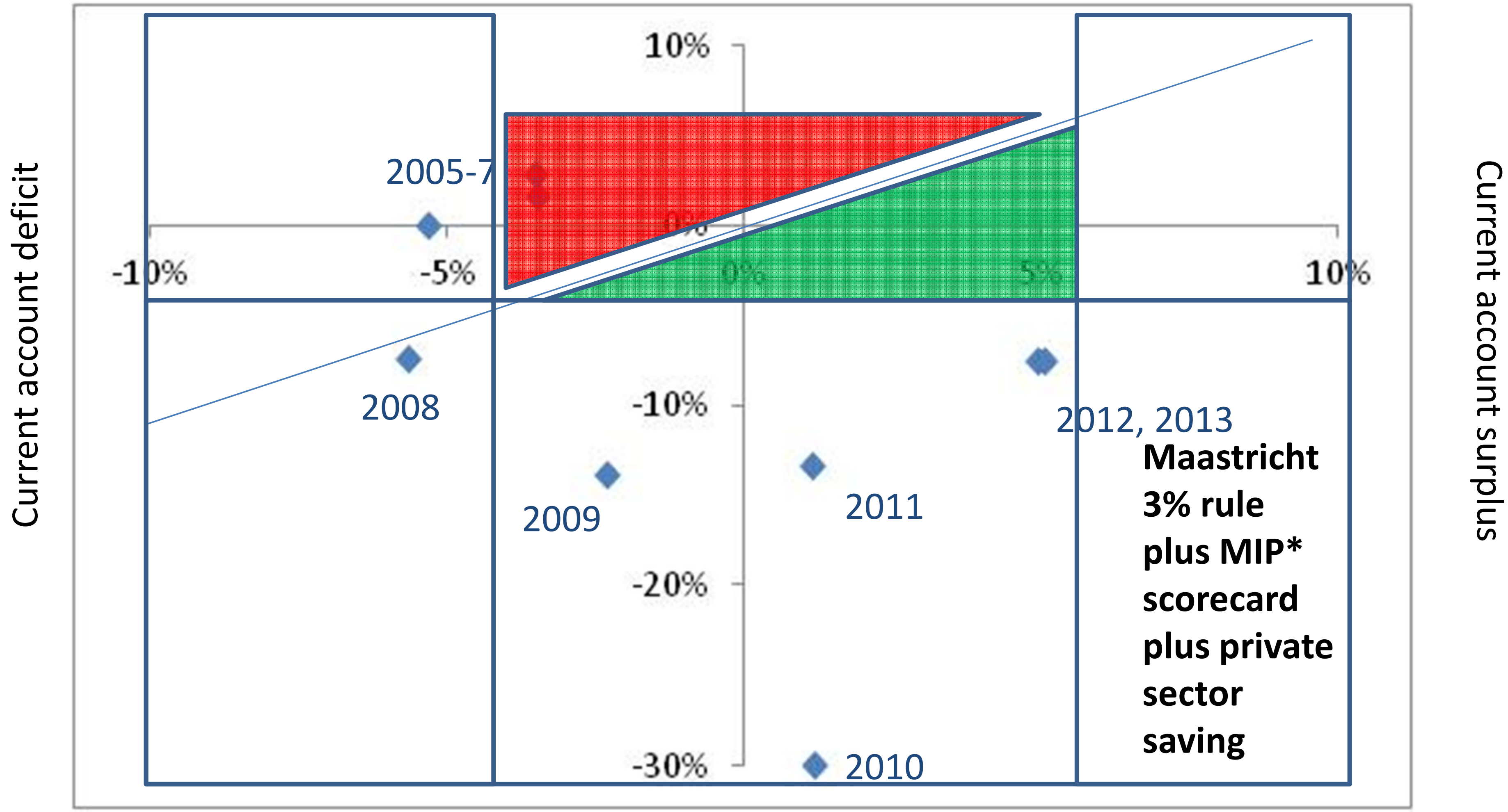
What about EU policies... Maastricht...



… and the EU 'scorecard'…

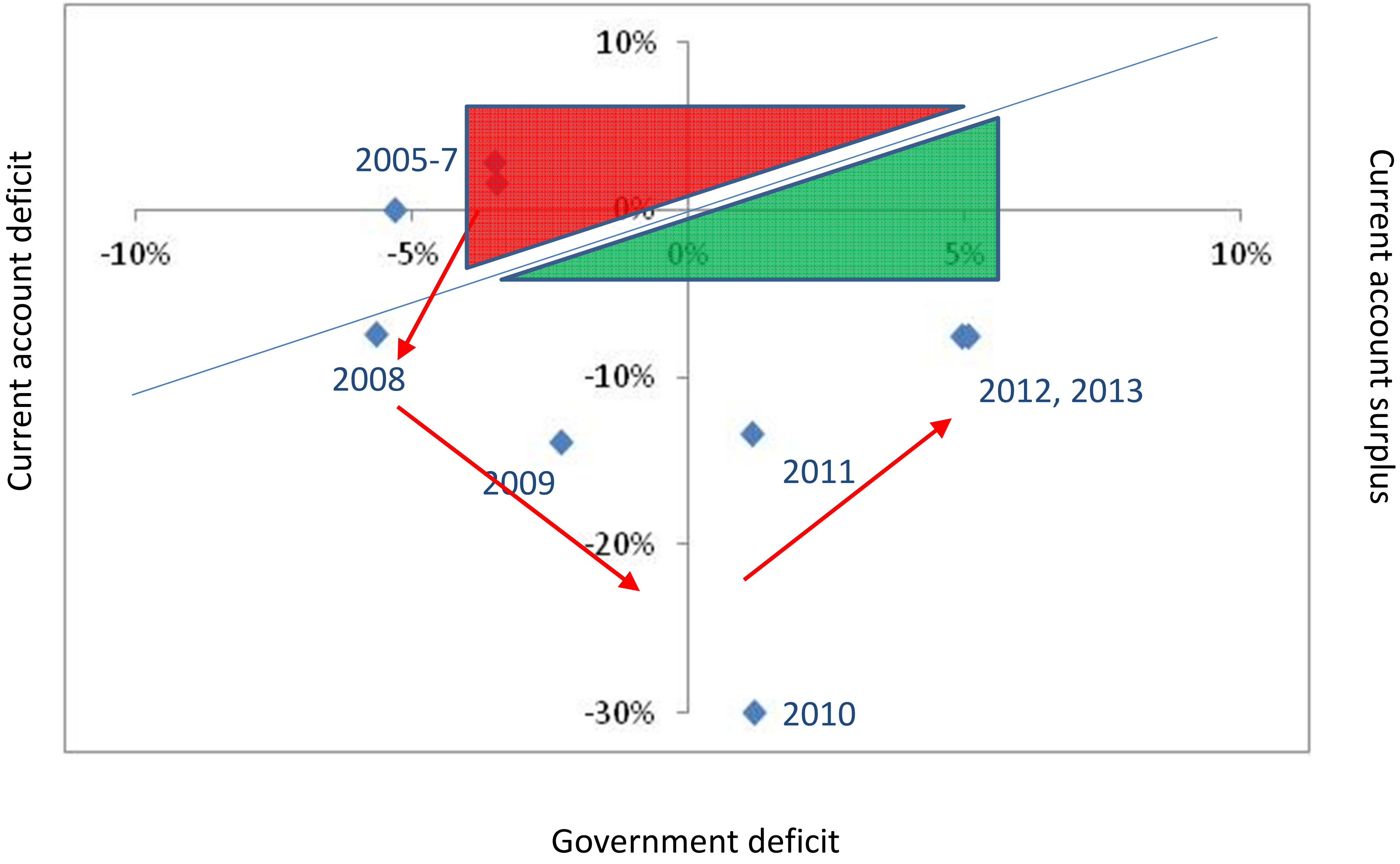
*European Commission, Alert Mechanism Report 2014

Leave little fiscal space



*European Commission, Alert Mechanism Report 2014

.. with an uncertain outcome

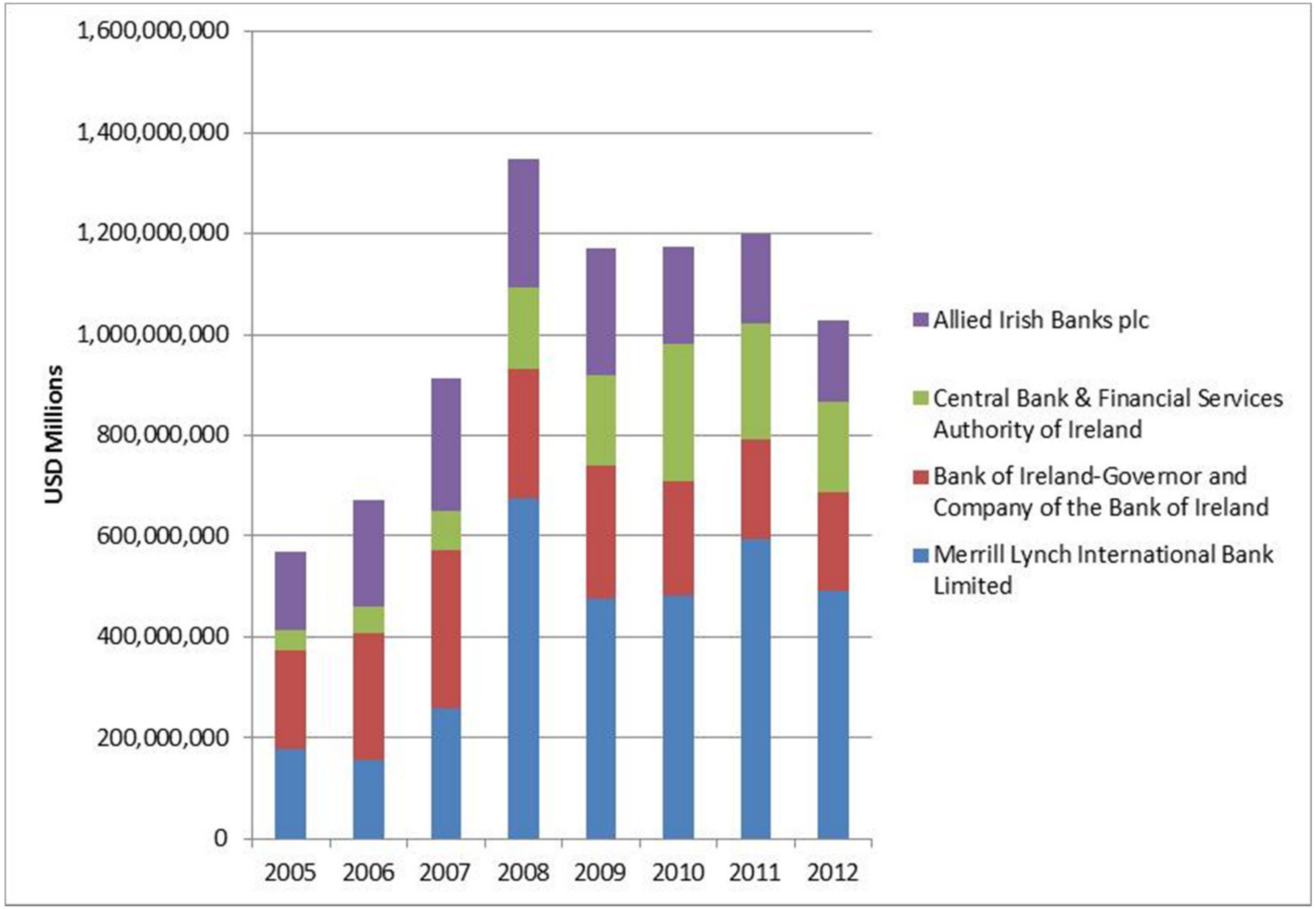


Wealth and capital gains impact spending

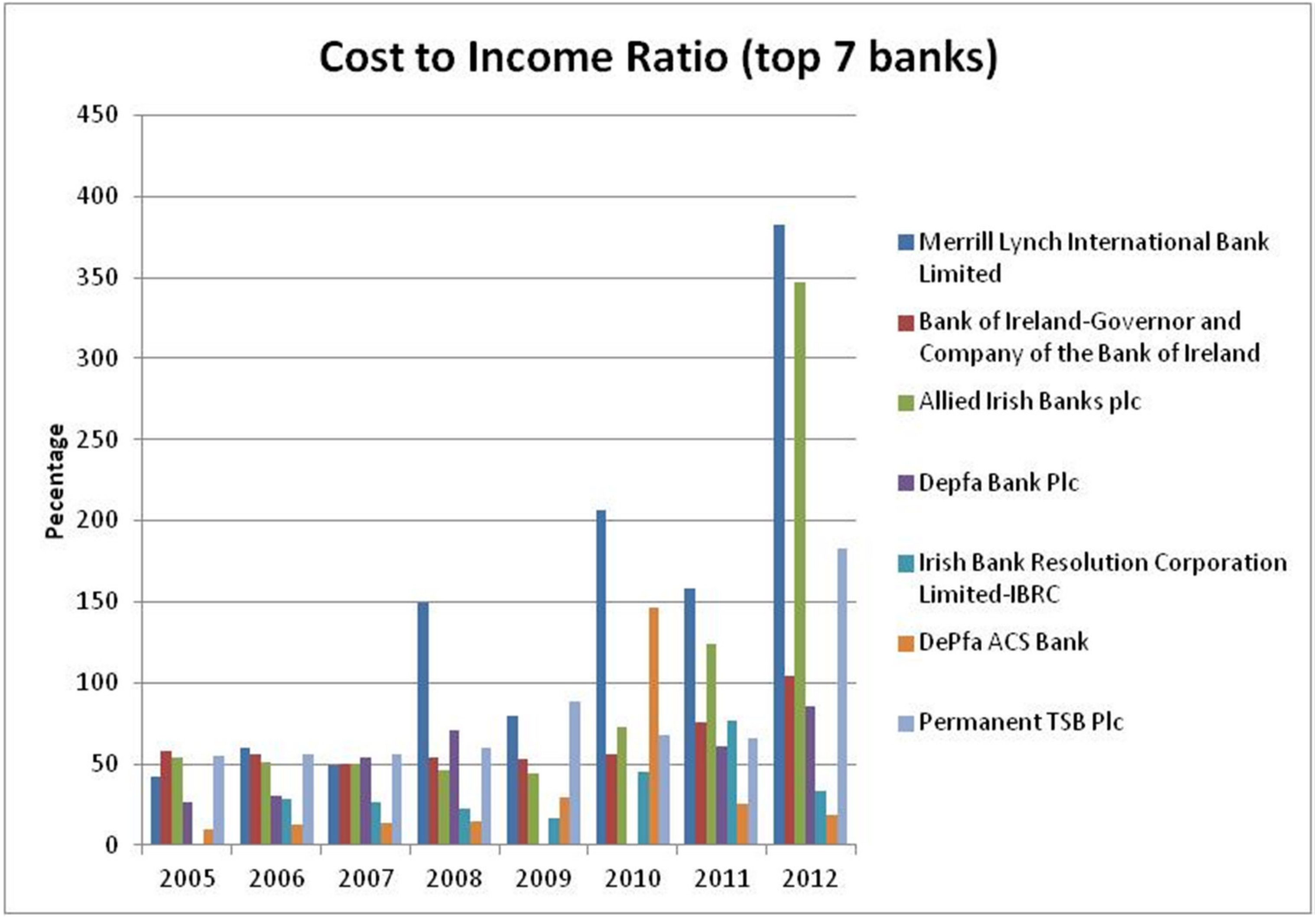
	Households	Firms	Banks	Shadow Banks	Government	Σ
Tangible assets	+H	+K				+H +K
Financial assets *	$+ p_s S_h$	$-p_s S$	$-p_s S_b$	$+p_s S_{sb}$		0
Govt bonds	$+p_b B_h$			$+p_b B_{sb}$	$-p_b B$	0
Loans, including mortgages	$-(1+r_L)L_h$	$-(1+r_L)L_f$	$+(1+r_L)L$	$-(1+r_L)L_{sb}$		0
Σ	$+ NW_h$	$+ NW_f$	$+ NW_b$	$+ NW_{sb}$	$- NW_g$	+H+K

Adapted from Eatwell, Mouakil and Taylor, 2008

Banks rapidly leveraged...



… Problem started with Merrill Lynch



Summary

- A very interesting paper: dynamic SFC model estimated using OLS and with a good fit to the data
- Data can always be further disaggregated (eg: central bank, derivatives, ‘shadow’ banks, currency/duration)
- Main criticisms: wealth, financial behaviour, profit retention and tax avoidance impact flows
- Is SVAR appropriate for correlated shocks?
- What about policy alternatives at the EU level... symmetrical constraints/scorecard, stronger EU fiscal powers?
- What impact will EU tax treaties (harmonisation) have on financial behaviour?

Reserve slides

Euro to USD


Data Chart
1.6
1.5
1.4
1.3
1.2
1.1
1
0.9
0.8
2000
2002
2004
2006
2008
2010
2012
2014

Private capital raising in Europe...