

Report for the Swedish Fiscal Policy Council

Public Presentation

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Government Assets and Liabilities

Discussions of fiscal policy mostly focus on *net* public assets / debt

- Inter generational equity
- Efficiency of tax collections

Fiscal Policy Council inquired about *gross* positions, government balance sheet

- Do gross assets and liabilities matter, or just net assets?
- How should the balance sheet be structured?
- Implications for fiscal framework (medium term surplus target)?

Gross Positions Matter

Gross positions affect long-term evolution of net assets

- Net assets $n_t \equiv a_t - l_t$
- Specific (a_t, l_t) -combination determines evolution of n_t if interest- and capital-gains rates on a_t and l_t differ
- Similarly, appropriation of surplus for gross asset accumulation vs. gross debt repayment determines evolution of n_t

Balance sheet structure affects riskiness of net assets

- Net assets $n_t \equiv (a_t^1 + a_t^2) - (l_t^1 + l_t^2)$
- Appropriate choice of asset and liabilities structure reduces riskiness of n_t , depending on correlations
- More generally, balance sheet structure (maturities, asset classes, currencies, etc.) determines risk and return characteristics of net assets

Roles for the Government Balance Sheet

Exploiting arbitrage opportunities

- Gross should exceed net debt if borrowing rate is lower than return on assets (controlling for risk)

Insuring the government

- Balance sheet structure should support high (low) net assets in conditions when primary surplus falls (rises)

Implications for maturity structure, asset allocation, currency exposure

- Inflation as a shock absorber? Rather not

Strengthening resilience

- Debt should be long-term to avoid frequent, large rollover

Liquidity provision to private sector

- Gross assets and liabilities should be increased when commitment problems in private sector are more severe than in public sector

Fostering credibility

- Certain balance sheet structures strengthen the government's credibility, for instance regarding debt repayment
- Of limited relevance for Sweden

Fiscal Framework

Emphasis on medium term surplus target

- Why surplus rather than net assets? Inter generational equity and efficient tax collection objectives point to latter
- Former implies latter only conditional on specific interest rates, capital gains rates, appropriation of surplus

Alternative? Targets for net assets and speed of convergence

- Net asset target reflects inter generational equity objective
- Speed of convergence (after fiscal shocks) target also reflects efficient tax collection objective

No targets for gross assets and liabilities

- Net asset target to alleviate risk of opportunistic policy
- Gross assets and liabilities less exposed to such risk
- Gross positions need to be adjusted frequently

But gross positions should be explained

Drawbacks of change of target

- Potential loss of credibility
Should be made clear that change concerns means not ends
- Valuation effects may introduce volatility
Speed of convergence should account for this