



Beyond Public Debt

The hidden rapid erosion of EU governments' balance sheets is a threat that should and can be stopped

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Eleven years after the outbreak of the financial crisis, several countries are still crawling from the economic wreckage. While political tensions have led to much debate around the principle of fiscal prudence and concerns about 'moral hazard' enshrined in the debt and deficit criteria in the Maastricht Treaty as well as the 'no bail-out' clause in the Lisbon Treaty, not enough attention has been paid to the reasons why governments were so unprepared to respond.

In particular, one of the fundamental sources of the present situation is missing from the debates: the absence in many member states of a proper public financial management culture. Many EU economies have in fact mortgaged future consumption and growth and shifted the burden of debt to future generations without creating the basis for the sustainable and sustained growth necessary to carry such levels of liability.

While levels of debt were already rising beforehand, the crisis had a strong impact on public accounts. The banking crisis compelled governments to pump money into financially distressed credit institutions and – in the absence of fully operational national central banks – governments had little control over the spiralling debt dynamics.

Against this background and in the context of a weak political union, with no supranational fiscal capacity and mutual mistrust, quantitative easing and fiscal austerity were the only solutions the EU was able to propose or, in some cases, to impose. For the sake of saving the incomplete architecture of the euro area, several governments were forced to make massive corrections, which have severely undermined social cohesion in certain countries.

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A recent CEPS study¹ using the results and methodology of the Kazarian Centre for Public Financial Management² estimates that the total financial and non-financial assets of governments in all EU member states in 2017 amounted to €15 trillion, while financial and non-financial liabilities amounted to €29 trillion. This means €29,600 in public assets and €58,200 in liabilities, or a negative net worth of €28,100 for each European citizen.

As a result, citizens began to experience a deterioration of public services alongside increasing taxation and a growing burden of public debt. Policymakers, journalists and even the general public started to focus on the debt dynamics in various EU countries. However, public debt is only one item on a government's balance sheet. On its own, debt is not representative of the state of public accounts. Financial assets and liabilities, indeed, represent only 30% of public sector balance sheets.

The CEPS study argues that government financial statistics are deeply rooted in historical practices that **do not represent the economic reality** of the government and the country. Most EU governments, for instance, do not publish consolidated financial statements based on internationally comparable standards. Non-financial assets and liabilities are often either not accurately reported or completely missing from the picture, including items such as public-sector pension liabilities. Most government accounts do not report non-financial assets, such as land, buildings and natural resources, leading to their mismanagement and creating costs rather than generating value. This predicament has arisen from the failure of several governments to put in place proper accounting systems and effective asset management strategies.

As governments manage approximately 50% of annual GDP, the lack of sound recording and management of assets can lead to substantial losses and serious consequences for society. Nevertheless, Europe does not have to reinvent the wheel. Modern techniques of public financial management – based on accrual accounting and budgeting – do exist and can be used to bring significant improvements to a government's financial position. It is worth noting that the accounts of the EU budget use international accounting standards, reporting assets and liabilities in full – a method requested by member states that do not use these standards themselves. Their introduction has been accompanied by a rapid improvement in efficiency and a quality of financial management that are widely underappreciated.

It is not only possible, but essential to reconcile sustained and sustainable economic growth and responsible fiscal policy. Governments should adopt modern Public Financial Management systems to start extracting value from public assets and effectively managing their liabilities. This will also allow governments to generate a social and economic value to the economy that exceeds the value of liabilities they take on in the implementation of their functions.

¹ Núñez Ferrer J., R. Musmeci, P. Kazarian (2018), 'Beyond Public Debt and Deficits – The Hidden Rapid Erosion of Government Balance Sheets is a Financial Threat to Society', [CEPS Research Report No. 10, March 2019](#).

² This methodology estimates the total assets and liabilities of government assuming they applied the international public accounting standards (IPSAS).