

Arrears

di Mario Nuti

One of the factors that have slowed down Italian growth in the current crisis, even relatively to a sluggish Eurozone, is undoubtedly the endemic accumulation of large scale arrears in Public Administration payments to enterprises for their supply of goods and services to central and local government. True, the very expectation of payment delays tends to be built into enterprise costs and therefore inflate the volume of public expenditure, but even so the build-up of arrears remains a sick anomaly in any market economy, which especially in a tight credit market such as at present can drive even healthy, successful enterprises to lay-offs and bankruptcy.

The very scale of such public arrears is uncertain, which makes it worse. A year ago the Bank of Italy estimated the commercial debt of the Public Administration to be of the order of €90 bn at the end of 2012. Since then €24 bn have been paid off, but there have been new gross additions to the total. A conservative estimate of current arrears is above €80 bn (La Repubblica, Economia e Finanza, 10 March 2014, p.2) while estimates by the Confederation of Italian Industry put them at as much as €120 bn. Many of the arrears involve off-budget, non-certified expenditures.

The idiosyncrasy, not to say the idiocy of the “internal” Growth and Stability Pact constraints, translating Maastricht macroeconomic constraints into local authorities’ microeconomics, often prevents payments even when expenditures are properly budgeted for and finance is available. Anal retention on the part of high officials of the Ministry of the Economy and Finance, also in order to avoid possible accusations of payments breaking European constraints, is an additional factor. But an accounting convention that wholly or partly reckons expenditures and revenues on a cash basis (“bilancio di cassa) rather than on accrual (i.e. including also receivables and payables, as in the “bilancio di competenza”) actually provides an incentive for the Public Administration to obtain, as it were, free credit from enterprises in a way that does not affect adversely its financial performance, regardless of the massive costs inflicted as a result on the economy and its viability and growth.

Clearly from a substantive viewpoint it makes no difference whether the Public Administration owns given arrears to enterprises, or borrows from banks or the financial markets an equivalent amount to pay them off, in which case it does not augment its debt but simply transfers it from the enterprises to new creditors. Financial markets are most unlikely to respond adversely to the Public Administration reducing payments arrears through additional borrowing. But with cash

accounting the arrears are not counted as part of expenditure or as a component of debt, whereas the equivalent borrowing does in its entirety. Hence the incentive to let arrears grow.

The popularity of cash accounting belongs to a past in which the control of the money supply in order to control inflation was a paramount preoccupation at all costs, even if the accumulation of Public Administration arrears towards enterprises involved the collapse of the real economy.

This accounting convention has already made immense damage in the course of post-socialist transition in the early 1990s, when the International Monetary Fund made monthly disbursements to Russia conditional on its respect of cash limits to the state budget deficits, thus encouraging the explosion of arrears owed to enterprises, or owed to state employees, or even to old age pensioners. As the Russians used to say, “Pay As You Go” then meant: First you pay, then you go. Italian so called “esodati”, whose entitlement to pension matured through early retirement was vanquished by the sudden rise of pensionable age decreed by the indefensible, unconscionable Minister of Labour Elsa Fornero of the Monti government, could choose this as their motto.

Such an obtuse and nonsensical policy fostered by the IMF in Russia in the early 1990s, in addition to an interest rate positive and large in real terms up to usury levels, and an associated overvalued exchange rate, led to mass unemployment and the parallel accumulation of inter-enterprise debt of the order of 40% of manufacturing enterprises turnover. This de-monetisation of the economy was one of the most important factors in the transformation recession of Russia in the 1990s, which destroyed more than one third of Russian GDP. By the same token the build-up of arrears is one of the factors that took current Italian recession above the European and Eurozone average.

Moreover, accounting conventions differ in Italy and Europe, and for different items of expenditure. Capital account expenditures (perhaps 20% of total arrears, though the precise proportions are also unknown) are always accounted for on a cash basis, both in Europe and in the “internal” so-called Growth and Stability Pact. Current account expenditures (the remaining roughly 80% of arrears), on the contrary, are accounted for on an accrual basis by Europe, and on a cash basis according to the “internal” Pact. Thus past current account expenditures, already accounted by Europe on accrual, can be paid without impacting the European 3% deficit ceiling in the payment year, having been accounted for already in the deficits of past years; whereas capital account payments in 2014 count against the deficit ceiling in that same year.

Franco Bassanini (President of the Cassa Depositi e Prestiti, CDDPP, a public agency managing postal savings, funding infrastructure and public enterprises) and Marcello Messeri (Rome LUISS University) worked out for the ASTRID Foundation a clever and simple method for

getting rid of all Public Administration payment arrears, both on capital and current account, without infringing expenditure and deficit (and therefore debt) ceilings.

Namely, Public Administrations would be asked to verify, and either challenge or certify within a period of 2-3 months, any claims of payment arrears by commercial suppliers. Certified credits would be guaranteed by the state (guarantees being a contingent quasi-fiscal liability of the state, not accounted for as expenditure) and could therefore be discounted by banks at a small premium (of 1%-2%, and anyway under 2% for the credit to continue to enjoy the state guarantee). Banks would have an incentive to accept them because they could always use them as collateral with the ECB to obtain liquidity, and moreover would improve the position of Public Administrations towards the banks themselves. Beneficiary enterprises could in turn reduce their liabilities towards suppliers, invest and hire new employees. VAT owed on unpaid arrears and currently suspended would also be paid, providing additional government revenue. J.P. Morgan calculated that in Spain, which was suffering from a similar predicament and paid off about €30 bn of Public Administration commercial debts, GDP grew by 1.2% as a result; in Italy the impact on growth could be greater. (See the interview with Franco Bassanini in La Repubblica, 10 March).

On 18 March 2013 EU Vice-Presidents Antonio Tajani and Olli Rehn had already accepted that “attenuating factors could be applied to the liquidation of commercial arrears” from the view point of the Growth and Stability Pact, but the principle was implemented only partially, thus involving the Ministry of the Economy and Finance in complex intermediation to establish eligibility and priorities, that slowed down the reduction of arrears. And last summer amendments removing state guarantees and establishing undetermined ceilings to arrears reduction stopped payments altogether under Enrico Letta’s government.

In a recent TV programme Franco Bassanini declared that current account arrears (which he put at between €20 bn and €100 bn) could be specifically removed from the “internal” Growth and Stability Pact, having been already included in past deficits, and paid by next June, while capital account arrears (of between €5bn and €10 bn) could be paid by 21 September as announced by the new Premier Matteo Renzi. Public Administrations without the necessary funds could take a 5-year loan guaranteed by the state, which in case of insolvency would be acquired by the CDDPP, on a longer maturity basis of the order of 15 years. More power to his elbow.