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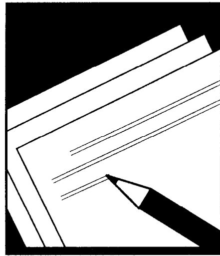

IMF Policy Discussion Paper

Should Italy Sell Its Nonfinancial Assets to Reduce the Debt?

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European Department

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Abstract

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This paper assesses the proposal, publicly debated in recent years in Italy, to reduce public debt by selling public assets, especially nonfinancial tangible assets. The main findings indicate that, although selling public assets has some merit if done to make more productive use of them, practical complications abound. Moreover, such sales might weaken underlying fiscal discipline. Other heavily indebted countries have reduced their debt much more than Italy without heavy recourse to extraordinary sales. In this context, the case of Belgium is of particular interest. Weighing the trade-offs, if properly and transparently done, the sale of public assets can complement, to a limited extent, fiscal consolidation, but should not be considered as an alternative to it.

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Keywords: Public debt reduction, public net worth, sustainability of public finances, fiscal adjustment, strategy for managing public assets.

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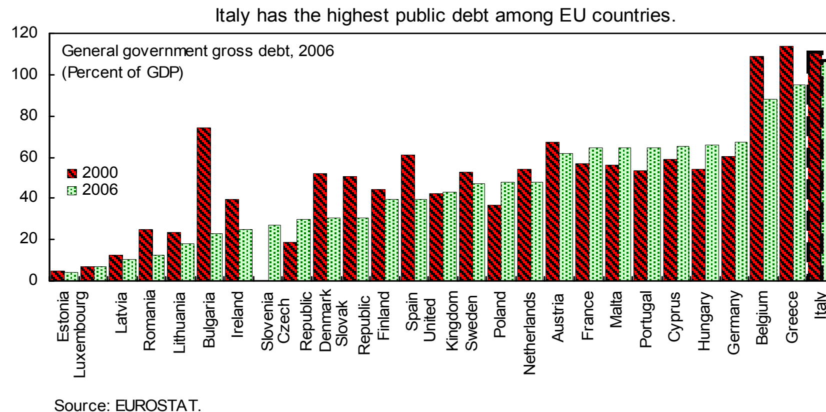
I. Introduction

Italy has the highest public debt in Europe.[1] It has never been a low-debt country (Box 1). Like a few other European Union (EU) countries, Italy joined the European Monetary Union (EMU) with a debt-to-GDP ratio above 100 percent. But these previous "fellow outliers" have succeeded in substantially reducing their debt, leaving Italy as the largest remaining outlier.



Based on current policies, prospects for durable and substantial debt reduction are remote. Taking into consideration factors such as increasing aging-related spending, debt is expected to continue to rise slowly in the medium term and sharply increase after 2030.

Box 1. Italy Has Never Been a Low-Debt Country

For most of the time between the unification of the country and World War II, public debt was above 60 percent of GDP. In three periods it went above 100 percent of GDP: at the end of the nineteenth century, after World War I, and during World War II (Francese and Pace, 2008). A period of relatively low debt in GDP terms was the mid-1960s (in 1964, debt was below 30 percent of GDP with a balanced budget). Debt, however, started to rise again with the rapid expansion of primary expenditure (which jumped from 29 percent of GDP in 1964 to 43 percent in 1985), accompanied by an increase in interest spending. In the mid-1980s, the authorities embarked on fiscal consolidation as they recognized the unsustainability of the fiscal position (Franco and Rizza, 2008). But despite the adjustment, public debt rose to almost 100 percent of GDP in 1991. The debt grew until 1994, when it exceeded 120 percent of GDP, partly because of large valuation effects following Italy's exit from the European Exchange Rate Mechanism. Afterward, in the run-up to euro adoption, Italian debt declined, helped by emergency measures, privatization, and declining interest rates. After Italy joined the EMU, the debt ratio continued to decline, helped by lower interest spending, but it started to grow again in 2005, as the primary balance deteriorated and economic growth continued to languish.

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[1] Public debt refers to general government debt.

One option being publicly debated is selling part of the state's assets to reduce public debt. Broadly, this would be done through the creation of a holding company (initially the state would be the only shareholder), with capital equivalent to the value of the public assets for sale; this company would sell public assets and be listed on the stock market. The debt would be reduced using the proceeds of the sale of assets or through the sale of the equities of the company (see, among others, Guarino (2005 and 2007); Franco (2007); and de Cecco (2007) for details on the proposal and comments). The sums involved, are, at least theoretically, larger than the debt: in 2003, the stock of total public assets was estimated to be about 130 percent of GDP.

Italy: Public Sector Balance Sheet (Estimated Values), 2003
(Percent of GDP)

	Central government	Local governments	Social security funds	Public sector
Total assets	73.2	48.6	10.8	132.6
Of which:				
Equity investments	8.0	5.8	0.0	13.9
Intangible fixed assets	1.6	4.7	0.0	6.3
Tangible assets	42.9	29.2	0.5	72.6
Of which:				
Land	0.4	2.7	…	3.1
Natural resources	10.8	1.8	…	12.7
Residential buildings	0.4	4.9	…	5.3
Nonresidential buildings	2.9	4.1	…	7.0
Infrastructures 1/	21.4	13.5	…	34.8
Total liabilities	73.2	48.6	10.8	132.6
Debt	101.4	5.3	…	106.7
Provision for future risks and charges	0.2			
Net equity (deficit)	28.4	43.3	10.8	82.6

Source: Ministry of Economy and Finance, *Italy's Stability Programme,* Update November 2004.

1/ This item includes infrastructure in transport (e.g., railways and motorways), energy (e.g., electrical grid) telecommunications (e.g., fiber optic network), and education (e.g., schools).

The purpose of this paper is to assess this proposal, drawing from the European experience. This paper analyzes the pros and cons of selling public assets to reduce public debt, focusing on nonfinancial tangible assets (real estate). It draws on the experience of other European countries, especially successful cases such as Belgium. With a view that these operations should be conceived as part of a strategic plan for optimizing the use of public assets, it also reports the experience of the United Kingdom in this area.

The paper concludes that, although the proposal has some merits, high risks to fiscal discipline should not be underestimated. If done to reduce the state's involvement in the economy and make a more productive use of the assets, the operation can have direct benefits on the economy, at the same time it can help reduce the gross public debt if the proceeds are used for such a purpose. But, while temporary measures can be attractive for the purpose of reducing debt, risks to fiscal discipline are high. Based on the European experience, recourse to such temporary measures has been made mainly when short-term (and shortsighted) fiscal considerations have dominated. However, the European experience also shows that, once short-term considerations such as joining the EMU have been relaxed, structural fiscal measures have been the main drivers of fiscal consolidation and debt reduction. Moreover, the experience of other high-debt countries indicates that it is feasible to substantially reduce public debt without resorting heavily to extraordinary operations.

The paper is organized as follows. Section II analyzes the direct financial impact of selling assets and presents some operational considerations. It then studies the indirect financial

impact on fiscal discipline, drawing on the experience of other EU countries. Section III presents the experience of other high-debt EU countries that successfully reduced their debt mainly through permanent fiscal measures. Conclusions and policy lessons are reported in Section IV.

II. Effects of Selling Assets to Reduce Debt

A. The Direct Financial Impact

It is particularly useful for highlighting the budgetary impact of fiscal measures involving asset transactions to focus on changes in government net worth (Milesi-Ferretti and Moriyama, 2006). From an accounting perspective, selling assets and using the proceeds to reduce debt does not directly affect net worth. From a purely cost-benefit point of view, the asset should be sold or commercialized if the return obtained is higher than the return (even if implicit) when the asset is in government hands. One could in this context add to the benefits the potential (though difficult to quantify) efficiency gain from decreasing the government's role in the economy (Landau, 1983; and Barro, 1990), although the empirical literature provides mixed evidence in this area (see, among others, Easterly and Rebelo, 1993; and Easterly and Servén, 2003).

In general, EU countries have not heavily sold nonfinancial assets to reduce debt. Unlike the sale of financial assets, nonfinancial asset sales have been used only marginally to reduce public debt. Italy, which stands out because of the amount of its nonfinancial asset operations, is estimated to have sold assets for about 2 percent of GDP over the period 1997–2006 (Momigliano and Rizza, 2007).

Examples of Operations Involving the Sale of Nonfinancial Assets in European Countries 1/

Country	Year		Percent of GDP
Austria	200–01	Sales of real estate	0.7
Belgium	2001–06	Sale of public assets	0.9
Finland	1995–	Securitization of ARAVA loans granted by the Housing Fund	…
Germany	1997	Corporatization of hospitals	0.2
Greece	2000–01	Securitization operations	2.6
Italy	2000–06	Securitization and sales of real estate assets	1.9
Portugal	2002	Sales of fixed line to Portugal Telecom	0.3
Denmark	1997	Sales of government buildings and land	0.1
Sweden	1998	Sale of real estate	0.9
U.K.	1997	Sale of Ministry of Defense buildings	0.1

Sources: Countries' authorities; Koen and Van den Noord (2005); Milesi-Ferretti and Moriyama (2006); and Momigliano and Rizza (2007).
1/ Some accounting differences may not be ruled out.

B. Some Operational Considerations

The sale of assets needs to be conceived and carried out as part of an overall strategic plan for managing public assets. As part of the strategy, the government would identify the surplus/low-return assets, with the primary objective of transferring the ownership of assets to the private sector while securing better value for money. At the same time, the strategy should focus on making more efficient use of the retained assets, thereby creating permanent savings, which can help improve public finances, as per the recent United Kingdom initiative (Box 2).

Assets need to have a price. A major operational difficulty in assessing financial returns is the valuation of nonfinancial assets, which include very heterogeneous properties, some of which do not have a market value, such as archaeological properties. The experience of privatization shows that transparency and accountability are critical to ensure public assets are not sold, or seen to be sold, cheaply and to prevent rent-seeking behavior. For Italy, the recently completed census of public properties conduced by the Agenzia del Demanio and the creation of a database containing the collected information are important steps in this area (Agenzia del Demanio, 2007).

Selling public assets may make previously implicit costs explicit. For example, selling houses rented at below cost to the poor would (if a market rent were then paid) make the implicit subsidy explicit. While this is in general a positive outcome, as the government and public could make a more informed decision about the policy and possibly make more efficient use of the released capital, this would involve increasing the explicit social transfer budget.

Those who own the assets may not owe the debt. Public debt is almost entirely owed by central government, but about 40 percent of nonfinancial assets are owned by local governments. This complicates their sale, as local governments, in particular ones that are fiscally responsible, may not be willing to pay with their own property for the fiscal indiscipline of the central government.

C. The Indirect Effect on Fiscal Discipline

Selling assets could indirectly weaken fiscal discipline, as it could create the “illusion” that, by lowering gross debt, public finances are more sustainable. The debt reduction could also induce fiscal relaxation, as there could be a sense that “room” has been created for additional spending. But, while the sale of assets has an immediate effect on gross debt, it does not

Box 2. Improving the Management of Government's Estate: The U.K. Experience

In 2006, the U.K. government launched the High Performing Property (HPP) strategy for transforming the management and use of public estates. Four key challenges were set:

- selling surplus assets to free resources for new investment;
- transferring ownership of assets to the private sector, securing better value for money;
- identifying and capitalizing hidden assets; and
- increasing value for money from retained assets and property.

The HPP set out actions and milestones for government organizations and their arms' length bodies. These actions were framed around four components:

- leadership and integration to (i) offset the effects of fragmentation of the estate; (ii) integrate asset management into strategic business planning and policy delivery across government departments and their arms' length bodies; and (iii) revisit governance frameworks;
- benchmarks and standards to (i) provide a framework that sets out best practice and performance objectives; (ii) provide tools, guidance, and support to help government organizations implement the practice set and meet objectives; and (iii) develop and use property asset management plans;
- skills and capability to ensure that skilled professionals are involved in the implementation of best practice across government organizations; and
- review to create a culture of evidence based on the review process and to improve accountability and transparency in property asset decision making.

In 2007, the National Audit Office conducted its first review of the performance of the government under the HPP (NAO, 2007); this is expected to realize about £1 billion (almost 0.1 percent of 2006 GDP) in annual efficiency savings by 2013. The review identified the main weaknesses in implementation and made detailed recommendations for improving the way in which government bodies strategically plan, occupy, and manage their office property requirements. In particular, the report stresses the need for (i) better data on building location, costs, occupation density, and day-to-day occupational level; (ii) better sense of relative performance to target improvements for individual buildings and across departments; (ii) better use of space through the introduction of flexible working arrangements; and (iii) reallocation of government posts from the most expensive regions to the cheapest.

necessarily modify the dynamics of debt, which would continue to increase.[2] For example, in Italy, the sale of assets and other one-off measures[3] were used extensively during 1997–2006 and helped in formally complying with the Maastricht fiscal criteria (Balassone, Franco, and Zotteri, 2007; and Momigliano and Rizza, 2007). However, these measures have not generally been accompanied by structural measures[4] to reduce deficits and debt. As estimated by the Bank of Italy (2006), the public-debt-to-GDP ratio would be approximately at its 1994 level had the sale of assets and other temporary measures not been used.

Based on the European experience, short-term fiscal considerations appear to have dominated when specific goals had to be met. In the run-up to monetary union, EU countries used the sale of assets to reduce liabilities and deficits with the intent of reaching the Maastricht fiscal criteria, as suggested by the positive correlation between changes in government liabilities and changes in government assets during 1995–2000 (figure below). These results are in line with the findings of Eichengreen and Wyplosz (1998), Koen and van den Noord (2005), and Milesi-Ferretti and Moriyama (2006).

III. Successful Experiences in Reducing Debt in Europe

However, in recent years, the same EU countries have adopted more structural measures to consolidate their fiscal position. The positive correlation between changes in government liabilities and changes in government assets during 1995–2000 has disappeared after 2000, and the improvements in net worth relative to changes in liabilities are much larger than in the previous period.

Other countries in Europe succeeded in reducing heavy debt burdens. In 1995, Belgium's public debt was 134 percent of GDP, 10 percentage points higher than Italy's. During the subsequent four years, under the incentive of joining the EMU, both countries substantially reduced their debt, and Belgium's debt fell almost to Italy's level (about 115 percent of GDP). However, while Belgium continued to reduce substantially its debt afterward, lowering it to about 88 percent of GDP by 2006, Italy's debt remained above 100 percent (106.8 percent of GDP in 2006). Ireland and Greece also succeeded in reducing their debt significantly after joining the EMU, with the debt-to-GDP ratios in both countries falling by about 20 percentage points.

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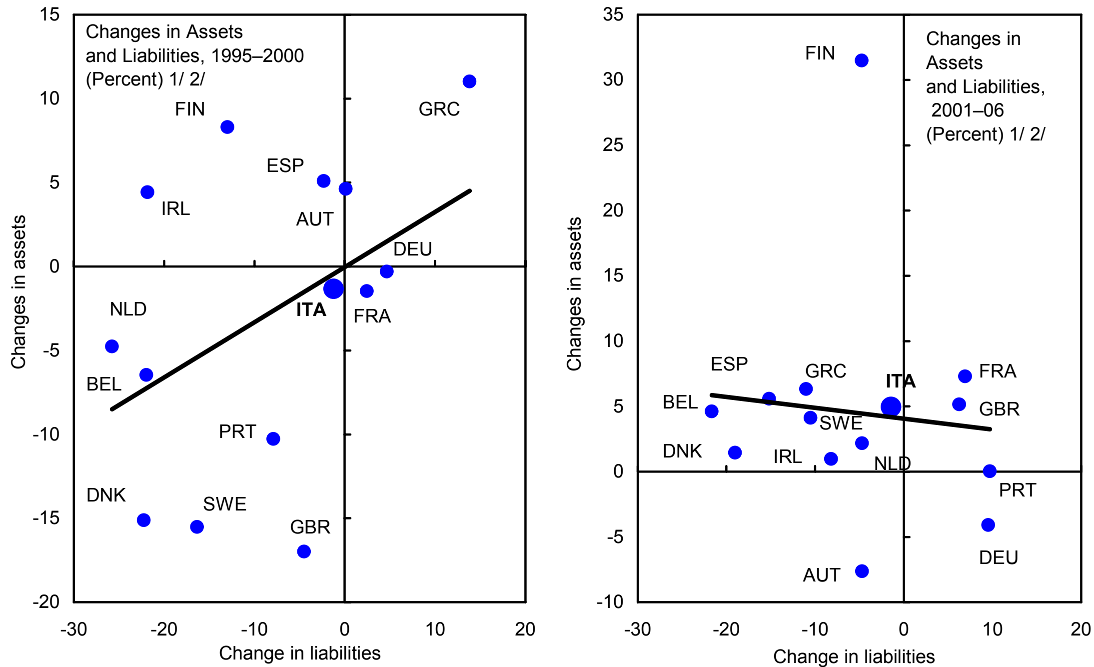
[2] Debt-to-GDP ratio developments depend upon the differences between the real interest rate on government debt and GDP growth rate, and the primary fiscal balance, Hence, selling public assets would have a temporary impact on debt, since it does not affect the main drivers of debt dynamics (economic growth and the primary fiscal balance), unless it reduces permanently the cost of debt to a lower level than economic growth.

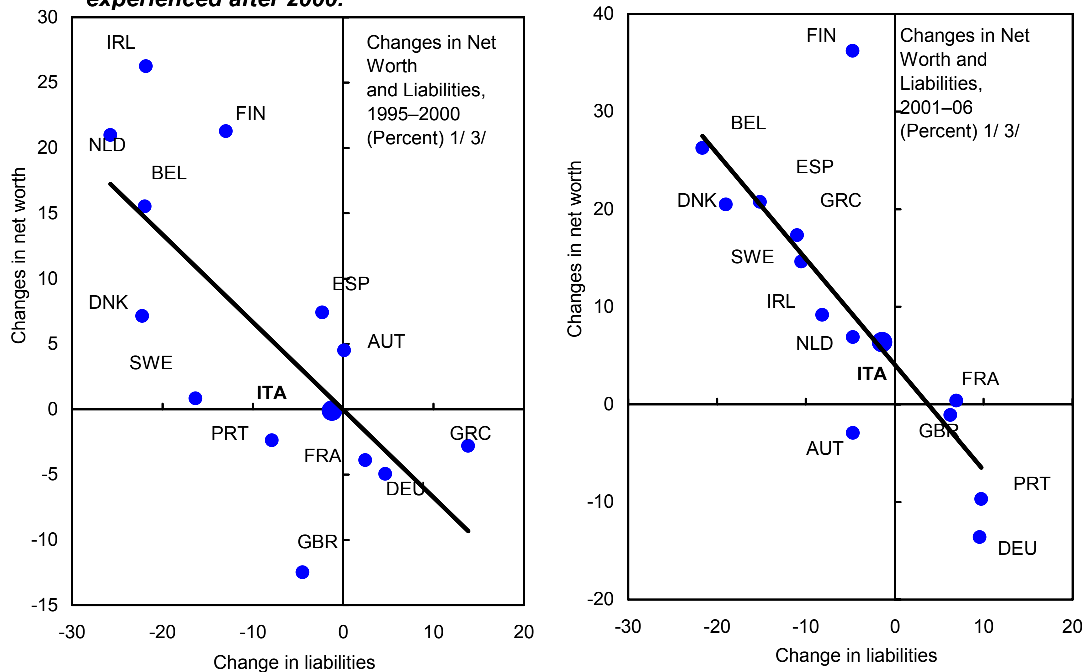
[3] One-off measures refer to government decisions of a nonrecurrent nature. They affect general government net lending/borrowing for a few years but not permanently.

[4] Structural measures, in this context, refer to government decisions that permanently affect general government net lending/borrowing.

Assets were sold to help reduce liabilities in the run-up to EMU, but sales declined afterward.



Much larger improvements in net worth relative to changes in liabilities were experienced after 2000.



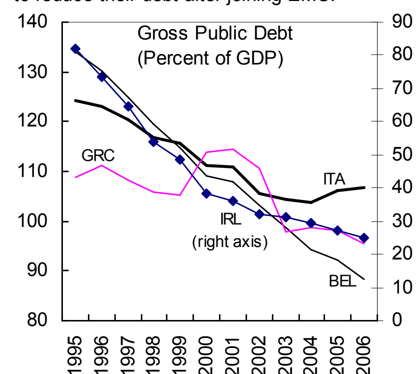
Sources: OECD; Eurostat; and author's calculations.

Note: Following Milesi-Ferretti and Moriyama (2006), the perpetual inventory method was applied to estimate the nominal value of nonfinancial assets.

1/ AUT= Austria; BEL= Belgium; DEU= Germany; DNK= Denmanrk; ESP= Spain; FIN= Finland; FRA= France; GBR= United Kingdom; GRC= Greece; IRL= Ireland; ITA= Italy; NLD= The Netherlands; PRT= Portugal; SWE= Sweden.
2/ The line represents the correlation between the changes in assets and changes in liabilities.
3/ The line represents the correlation between the changes in net worth and changes in liabilities.

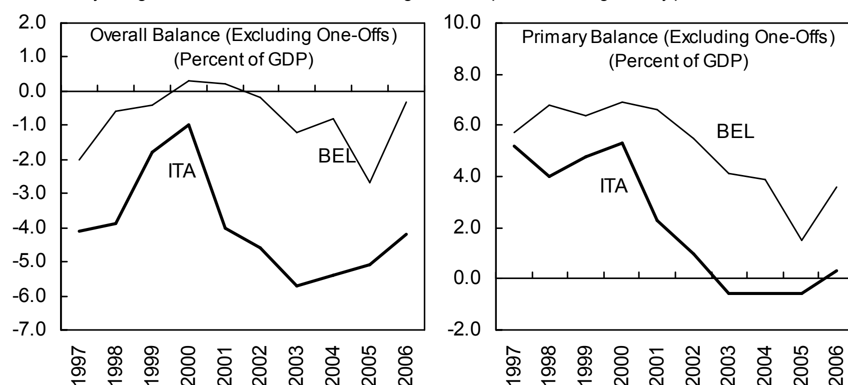
Unlike in Italy, however, debt was reduced in previous fellow outliers mainly through structural measures. Consider Belgium and Italy: both had similar debt levels in GDP terms when they joined the EMU, and their nominal economic growth was on average very close afterward (3.7 percent for Belgium and 3.5 Italy during 2000–06). While in Belgium, the accumulated primary balance without one-off operations between 1997 and 2006 amounted approximately to 50 percent of GDP, the consolidation in Italy was less than half of Belgium's. The different pace of debt reduction in the two countries also affected the increase in their interest spending. Based on the average cost of Italy's debt in 2006 (4.5 percent), if the debt ratio had been reduced by the same amount as in Belgium, approximately 0.8 percent of GDP in interest expenditure would have been saved in 2006 compared with the actual outturn (Momigliano and Rizza, 2007).

Unlike Italy, other high-debt countries continued to reduce their debt after joining EMU.



Source: EUROSTAT.

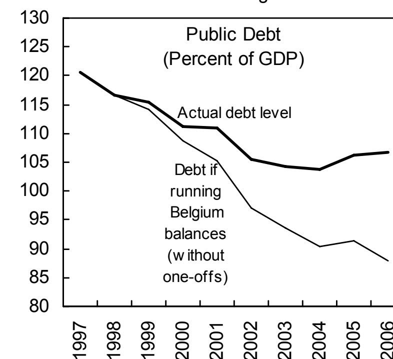
Unlike Italy, Belgium succeeded in consolidating its fiscal position using mainly permanent measures.



Sources: Bank of Italy; Bank of Belgium; and author's calculations.

Note: Some differences in the definition of one-offs cannot be ruled out.

Had Italy run similar budget balances as Belgium, its debt would be close to Belgium's levels.



Sources: EUROSTAT; Bank of Belgium; and author's calculations.

Had it been as fiscally disciplined as Belgium, Italy would be in a much stronger debt position. Had Italy targeted and implemented the same fiscal structural consolidation as Belgium (i.e., excluding one-off measures), its debt would have declined close to Belgium's debt levels. This would suggest that, without resorting to extraordinary measures, Italy could reduce its debt substantially. The key determinants of Belgium's successful fiscal consolidation appear to have been a major adjustment effort in the mid-1990s, which put the

debt-to-GDP ratio firmly on a downward path, followed by a policy of "maintenance" afterward. The fiscal adjustment involved a discretionary expenditure tightening combined with fiscal institutional reforms, in particular at the subnational government level (Bethuyne, 2005).[5]

IV. Conclusions and Policy Lessons

Selling public assets has some merits. If done to make more efficient use of the assets, the operation can also improve net worth, not just gross public debt. But there are many complications in selling assets, such as valuation and ownership.

A strategic plan of public estate management would help identify surplus assets while generating savings through a more efficient use of the retained assets. On the one hand, this would help set priorities and increase the transparency of the sale process, which should be conceived with the primary objective of securing better value for money. On the other, it would enhance the efficiency of estate management and, hence, create permanent savings, which would help improve public finances by reducing the need for extraordinary measures.

Beyond the practicality of the operation, there are grounds for expecting the sale of assets to create the illusion of fiscal space, hence undermining fiscal discipline. Based on the European experience, recourse to temporary measures, such as the sale of assets, was made when short-term goals, such as the Maastricht fiscal criteria in the run-up to the EMU, were the priority. However, longer-term fiscal considerations appear to have dominated once the pressure of these goals was relaxed and structural fiscal measures became the main drivers of fiscal consolidation and debt reduction, though less so in Italy.

The experience of other high-debt countries indicates that it is feasible to significantly reduce public debt without heavy use of extraordinary operations. In this context, Belgium is an interesting case due to its similarities with Italy in terms of initial debt conditions and economic growth. Since 1999, Belgium has reduced its debt by more than 25 percent of GDP, mainly through structural measures. Had Italy exercised the same fiscal discipline as Belgium, its public debt would be well below its current level.

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[5] Artoni and Ceriani (2007) claim that economic conditions must be the relevant factor underlying the different fiscal performance of the two countries after 1999, since the expenditure- and revenue-to-GDP ratios have been broadly constant in both countries. However, these authors do not take into consideration a major factor, the adjustment effort made in mid-1990, which put the debt on a downward trajectory and created a debt snowball effect.

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