

It's high time the integrity of economic statistics is seriously safeguarded

Alberto Giovannini

28 April 2010

Once upon a time, economic statistics served as the basic work tools of economists, econometricians and government officials. Beyond academia, statistics would be used by central banks plotting the variables of monetary policy; by governments, designing fiscal policy; and by international institutions, like the IMF, the OECD and the World Bank. Nowadays, however, economic statistics are, first and foremost, fodder for the financial markets, that is, for mass consumption. Economic statistics move prices: they have the same market impact as corporate information releases, if not an even bigger impact. After all, the size of government issuers is generally much larger than that of private issuers. In addition, data releases from governments can impact a wide range of different markets, including markets for private debt and equity.

By now, everybody knows how important it is to safeguard the functioning of financial markets and, in particular, to avoid the disruptions caused by inaccurate or mendacious data releases. Not surprisingly, the list of market failures triggered by misleading data releases is long: the Enron, Worldcom and Tyco accounting scandals come to mind and, of course, the apparent cover-up by Greece of its own ballooning fiscal deficits has become the classic case of government manipulation of statistics. The incentives private corporations have to misrepresent their financial condition are easy to understand: 'good-looking' financials boost executive compensations both directly (through the mechanics of incentive compensation packages) and indirectly through their impact on stock prices (and therefore executive compensation packages based on stock price performances, like stock options). In the case of governments, such incentives are less obvious, but could be equally powerful. It is said that in the 1970s some governments in high-inflation countries were systematically doctoring the official consumer prices data (MIT graduate students discovered this by doing their own direct surveys of consumer prices): their motivation was probably to avoid financial crises and thus assuring more stability in their own position of power. The recent Greek governments' initiatives may have been inspired by the objective to avoid both public (through the EU Excessive Deficits Procedure) and private market (through higher costs of debt) sanctions to fiscal profligacy. But allegations of improper official statistics are not confined to developing countries or poor Greece. Bill Gross, co-founder of PIMCO, a leading global investment management firm, has famously and repeatedly attacked the US government for the use of core-CPI data in its own inflation targeting and in particular, on the quality adjustments to the CPI

Alberto Giovannini is Chief Executive Officer of Unifortune SGR SpA, an asset management company based in Milan. At the European Commission, he was Principal Policy Advisor of the Clearing and Settlement Advisory and Monitoring Group (CESAME) and Chairman of the Giovannini Group. Mr. Giovannini was the Jerome A. Chazen Professor of International Business at Columbia University in New York and holds a PhD in Economics from the Massachusetts Institute of Technology.

CEPS Commentaries offer concise, policy-oriented insights into topical issues in European affairs. The views expressed are attributable only to the author in a personal capacity and not to any institution with which he is associated.

Available for free downloading from the CEPS website (<http://www.ceps.eu>) • © CEPS 2010

index, which Gross criticised as questionable at best and of course produced systematic downward adjustments in US inflation, by not insignificant amounts.

Corporate issuers in public markets are subject to a number of stringent rules governing their information releases. The general principle is that whatever they communicate to markets and investors has to be truthful and accurate, subject to high and uniform standards. In addition, no one inside a corporation can take advantage of knowledge they have about market-sensitive data through transactions in financial markets. In 2002, after the slew of high-profile scandals mentioned above, which have been associated with a collapse of world equity markets, the United States enacted the Sarbanes-Oxley Act, setting stronger information standards for all US public company boards, management and public accounting firms. All of these rules were conceived for the safeguarding of financial markets: How can anyone have any faith in securities markets where the issuers of those securities lie to the public about their finances? How can anyone want to use financial markets where it is known that insiders can use their privileged information to their own profit (thus causing losses to other market participants)? Those who publish wrong or misleading data are prosecuted by authorities; those who are able to show they have been damaged by inaccurate or mendacious corporate data releases can sue such corporations and claim damages.

None of these safeguards is present in the case of official statistics. In the public sector there are rules that are designed to ensure accuracy of economic statistics, and there are bodies whose mandate is to monitor such accuracy, together with cross-country comparability (Eurostat is one of them). However, the purpose of such rules is what I just described. They are not designed to avoid disruption in financial markets, and they do not explicitly recognise that faulty information can cause potentially very large financial losses to people. And, as recent experience teaches us, they have failed miserably.

The grand plan of financial market reform should include a small, but not insignificant, section aimed at correcting this problem. There should be a regime that constrains public sector data releases and subjects them to the highest standards, with the explicit view of protecting investors and market integrity. In the EU, the natural authority to define and enforce accuracy and proper handling of public sector data would appear to be the college of securities regulators, of course in conjunction with Eurostat. What is important is that governments recognise the fact that public statistics have an impact on private markets, and that any public official taking the initiative to 'doctor' public statistics inflicts (potentially very significant) economic damage to financial markets and, because of this, should be appropriately sanctioned. After all, ensuring the smooth working of financial markets amounts to protecting public trust and the proper functioning of the economy.