



## Disclaimer

# Boosting Medium-Term Growth: What Can Fiscal Policy Do?

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Views expressed here are my own and do not necessarily represent those of the IMF or IMF policy.

## Public Finances and Growth



- **Low growth and “lowflation” → pressure on fiscal policy**
  - Short-term: zero-lower bound,
  - Longer-term: incentivize and accompany structural reforms.
- **Public finances and growth:**
  - Macroeconomic stabilization: Stability is good for growth
  - Income distribution: inequality can negatively impact growth
  - Allocative efficiency:
    - The **microeconomics** of tax and expenditure policies matter for **macroeconomic performance**.
- **Necessary condition: sustainability**
  - **Credibility:** expectations can undermine effectiveness.
  - Importance of having a sound framework in place.

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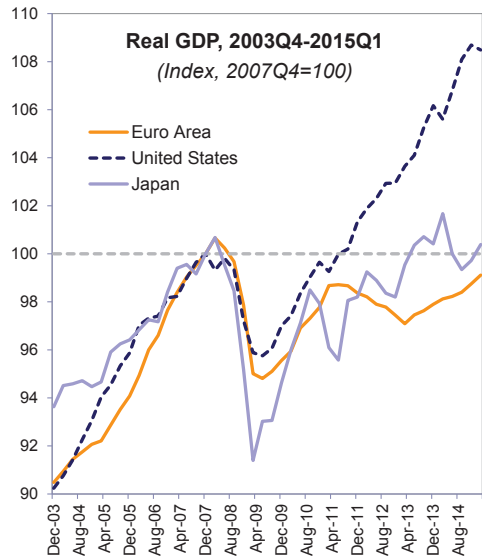
## Background



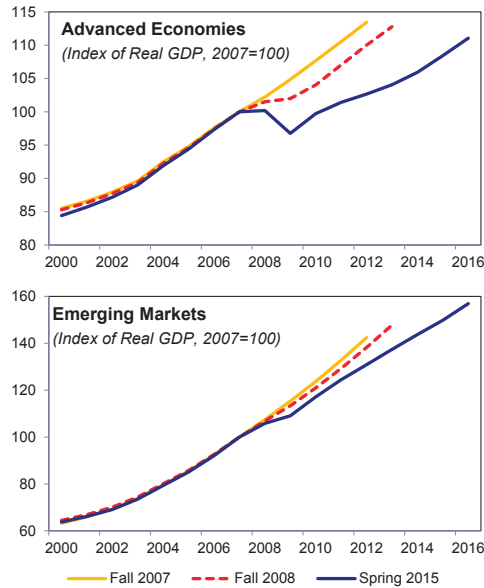
- **Growth dividend of macro stabilization:**
  - **Study for the April 2015 IMF Fiscal Monitor.**
- **Beyond stabilization → “Fiscal Policy and Long-Term Growth”** (<http://www.imf.org/external/pp/longres.aspx?id=4964>):
  - **Nine in-depth country studies**
  - **Analysis of 146 growth acceleration episodes in 112 countries**
  - **Model simulations**
- **Country studies covering a diverse set of cases.**
- **Based on these complementary techniques: infer the ingredients of a successful fiscal reform strategy.**

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## The global recovery remains weak and potential growth estimates have fallen

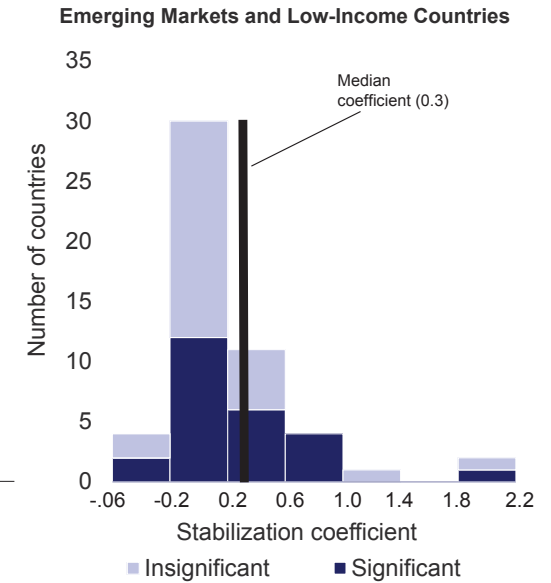
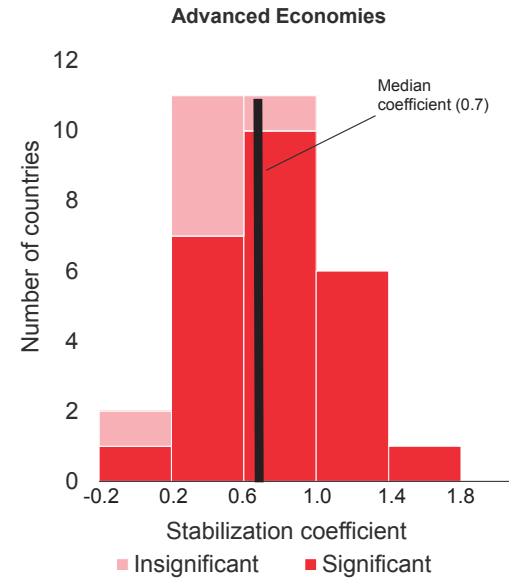


Source: Haver Analytics, WEO, and IMF staff estimates.



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## Fiscal stabilization is more widespread in advanced economies



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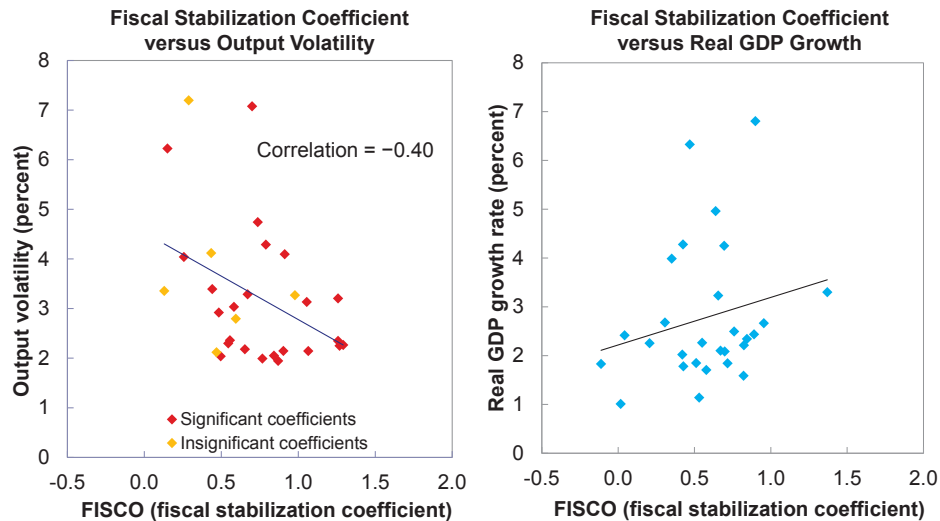
Fiscal stabilization is associated with lower output volatility and higher medium-term growth



Fiscal stabilization is positively correlated with real GDP growth and higher fiscal stabilization means more growth

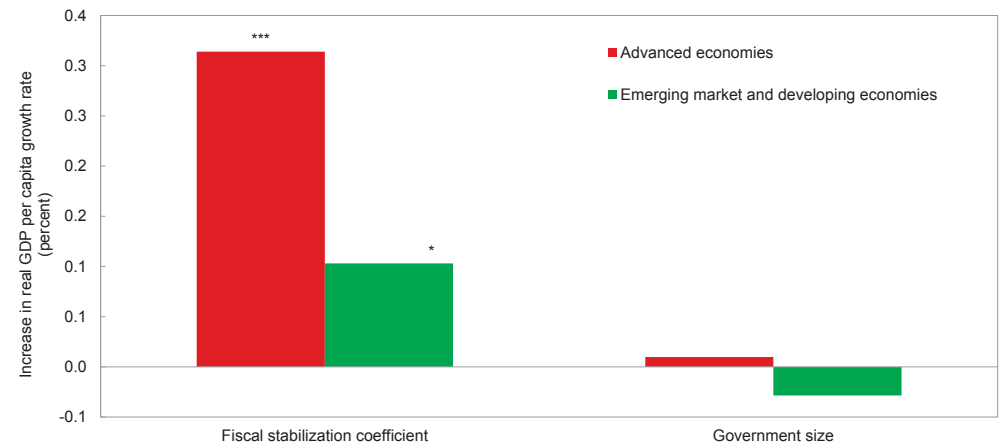


**Fiscal Stabilization, Output Volatility, and Growth:  
Cross-Country Correlations, 1980–2013**



Sources: IMF, *Fiscal Monitor*, April 2015, and IMF staff estimates

**Fiscal Stabilization and Medium-Term Growth**



Sources: IMF *Fiscal Monitor*, April 2015.

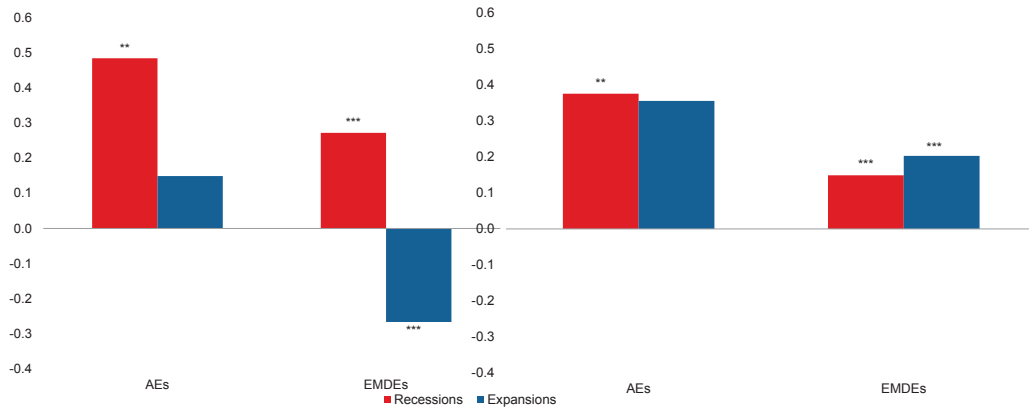
Note: Emerging market and developing economies include emerging market and middle-income economies as well as low-income developing countries.

\* p < 0.10; \*\*\* p < 0.01.

## Letting automatic stabilizers play is a first step



Fiscal Stabilization Coefficient varies over phases of the cycle



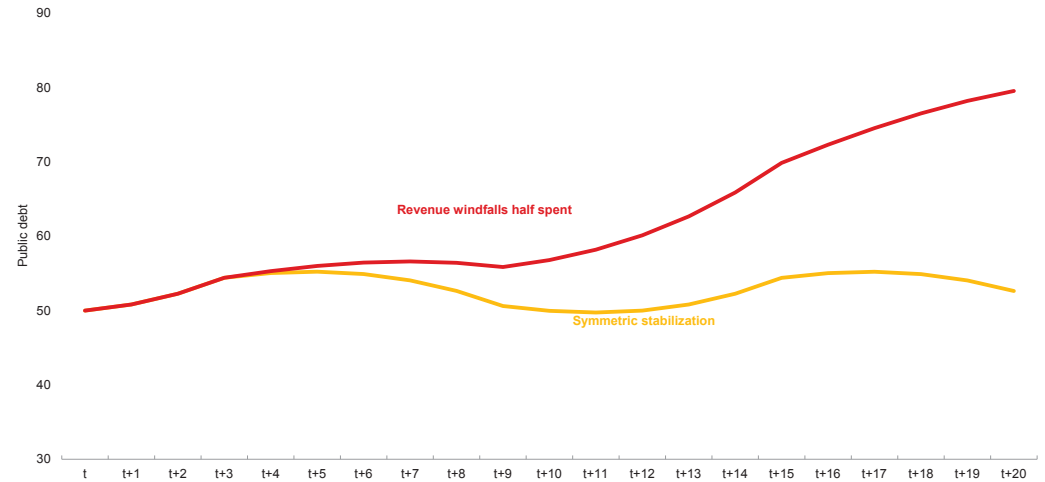
Sources: Fiscal Monitor, April 2015.

Note: Recessions and expansions are defined using an approach equivalent to the smooth transition autoregressive model developed by Granger and Terasvirta (1993). The figure displays ordinary least squares regressions with country and time fixed effects and robust standard errors. To reduce heterogeneity in the panel, commodity exporters have been excluded. AEs = advanced economies; EMDEs = emerging market and developing economies. \*\* p < 0.05; \*\*\* p < 0.01.

## Symmetric stabilization over the cycle helps sustainability: build buffers in good times.



Asymmetric Stabilization: Unpleasant Public Debt Arithmetic (percent of GDP)



## Ways to boost automatic stabilization



- **Tax deductions**

- Cyclical investment tax deduction
- Cyclical bonus depreciation
- Cyclical loss-carry forward
- Cyclical property tax

- **Expenditure**

- Automatic transfers to local governments
- Cyclical adjustment of unemployment benefits

## Beyond stabilization: key transmission channels of structural fiscal policies to growth



Labor  
supply

Human  
capital

Physical  
capital

Innovation

## There is a broad menu of growth-friendly fiscal reform options



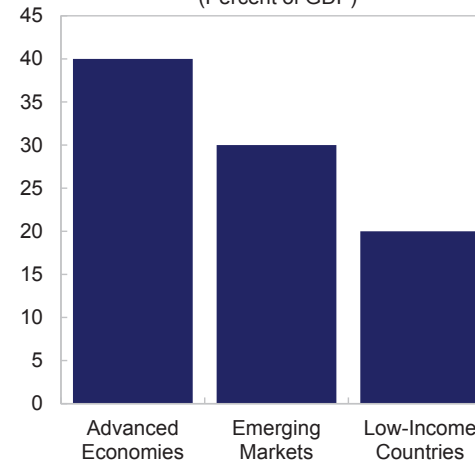
- Structural fiscal reforms can help build sound, growth-friendly, fiscal institutions.
- Both tax and expenditure policies can be made more growth-friendly.
  - **Labor supply:** Improving the design of labor taxes and social benefits strengthens work incentives.
  - **Human capital:** More equitable access to education and health care can contribute to human capital accumulation.
  - **Physical capital:** Reforming capital income taxes to tax rents reduces distortions and encourages private investment.
  - **Productivity/innovation:** Well-targeted tax incentives and efficient public investment in infrastructure can raise the economy's productive capacity.

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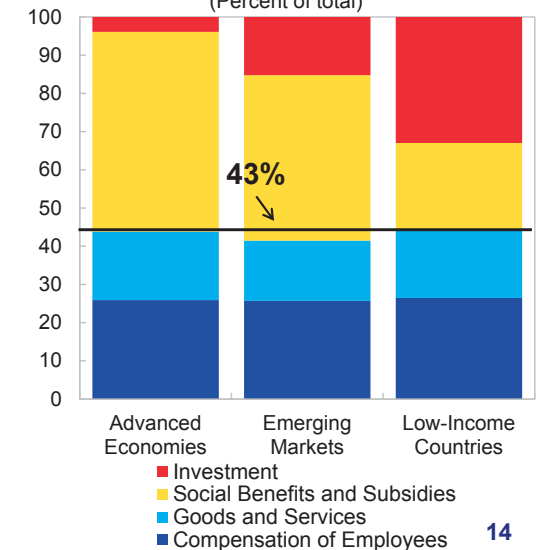
## Example 1: Improve efficiency



Public Expenditure, 2014  
(Percent of GDP)

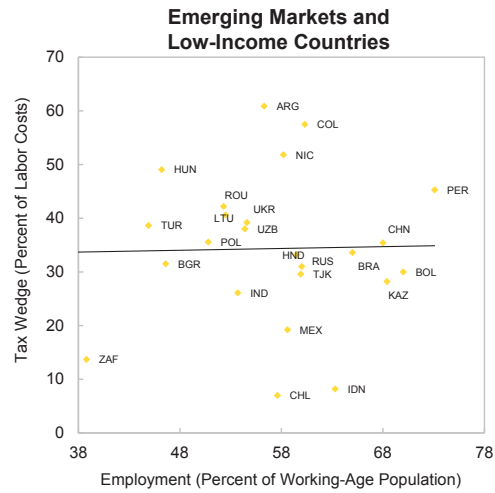
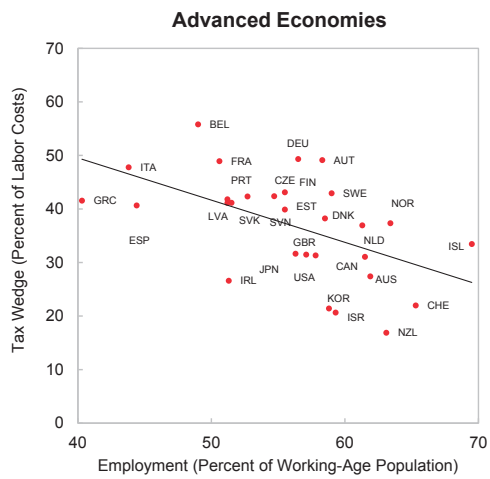


Public Expenditure Composition, 2007-2013  
(Percent of total)



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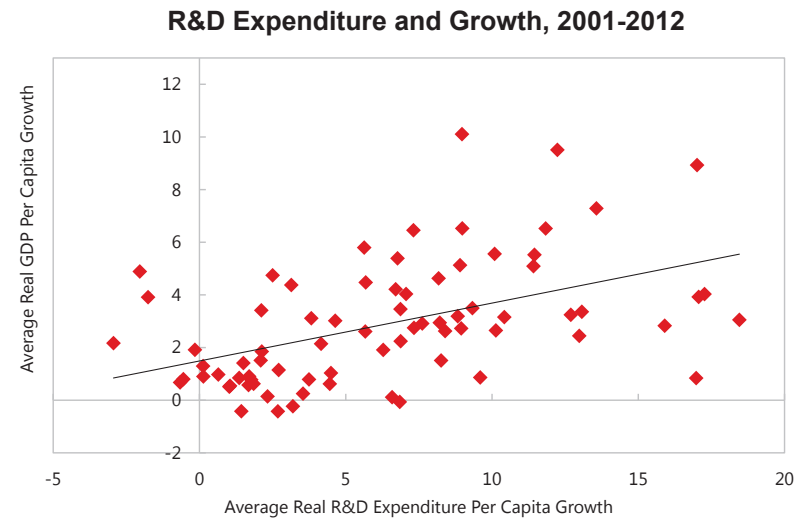
## Example 2: Strengthen work incentives



Source: IMF staff calculations.

Note: the black lines show an ordinary least squares (OLS) regression line.

## Example 3: Encourage private R&D



Source: World Development Indicators

Note: Excludes countries with fewer than five observations during the considered period.



## Evidence from Country Studies

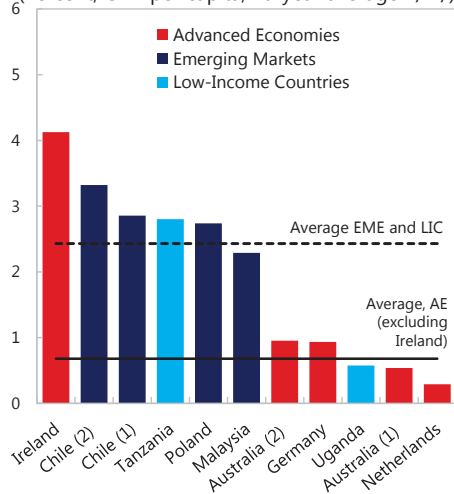


## Evidence from Growth Acceleration Episodes



### Estimated Growth Gain

(Percent, GDP per capita, 10-year average 1/ 2/)



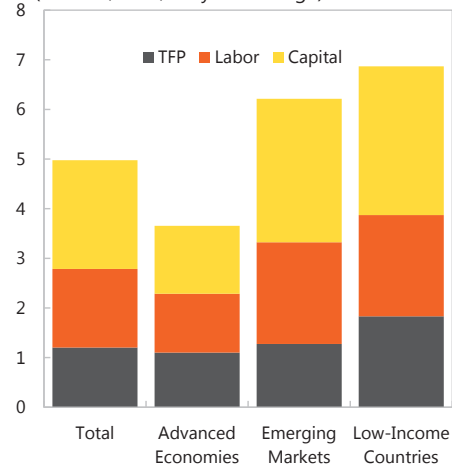
Source: IMF staff calculations.

1/ 5-year averages for Germany and Poland.

2/ Chile (1) refers to the first reform episode (1974); Chile (2) to the second reform episode (1983); Australia (1) to the first reform episode (1985); and Australia (2) to the second reform episode (1998).

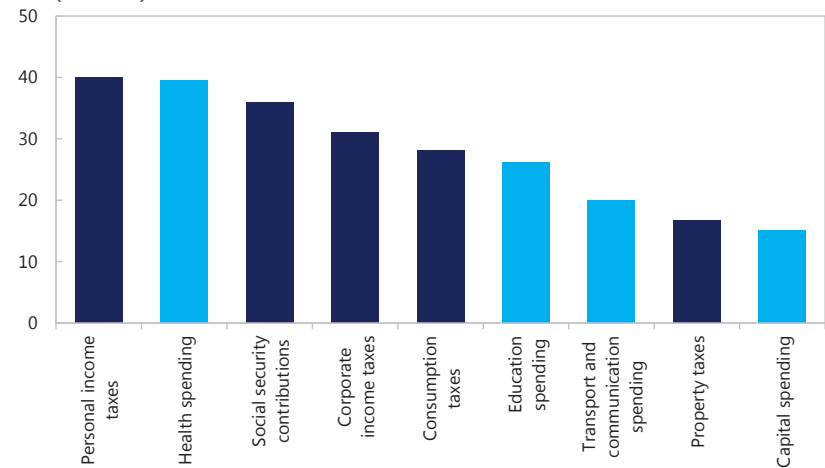
### Long-Term Growth Post-Reform

(Percent, GDP, 10-year average)



### Fiscal Reforms and Conditional Probability of Growth Accelerations

(Percent)

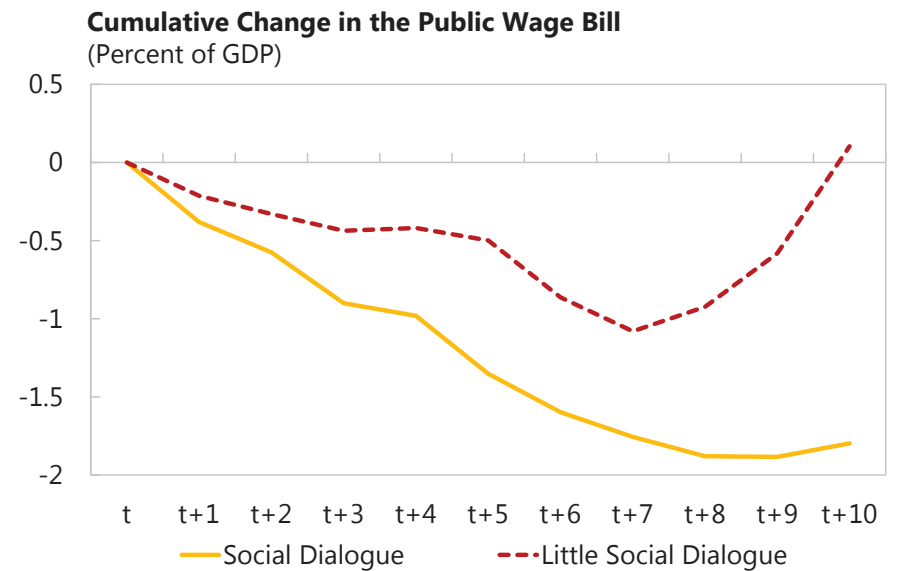


## Design Matters: Complementary reforms help maximize growth gains



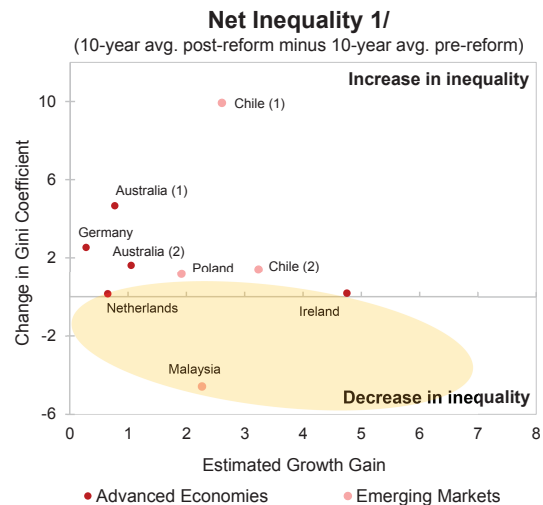
Source: IMF staff calculations.

## Design Matters: Public support helps deepen and sustain reform efforts



Source: IMF staff calculations.

## Design Matters: Equity-efficiency trade-offs can be avoided



Source: IMF staff calculations, SWIID 5.0.

1/ Refers to Gini coefficient after taxes and transfers.

## Conclusion



- **Fiscal stabilization matters:**
  - **Make it symmetric over the cycle, notably by boosting automatic stabilizers.**
  - **Dividend: 0.3 pp in advanced economies, less in developing.**
- **Fiscal reforms make a difference for long-term growth:**
  - **Evidence shows that growth increased by ¾ pp in advanced economies and by even more in developing economies.**
- **Reforms should be tailored to country-specific conditions.**
- **But their design matters: they are more effective when...**
  - **they are mutually reinforcing**
  - **they are complemented by structural and macroeconomic policies**
  - **they enjoy broad public support for their implementation**
  - **they contain measures to avoid equity-efficiency trade-offs**



**Thank You!**