PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

The Implications of Low Productivity Growth for Fiscal Policy

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Facing Up to Low Productivity Growth
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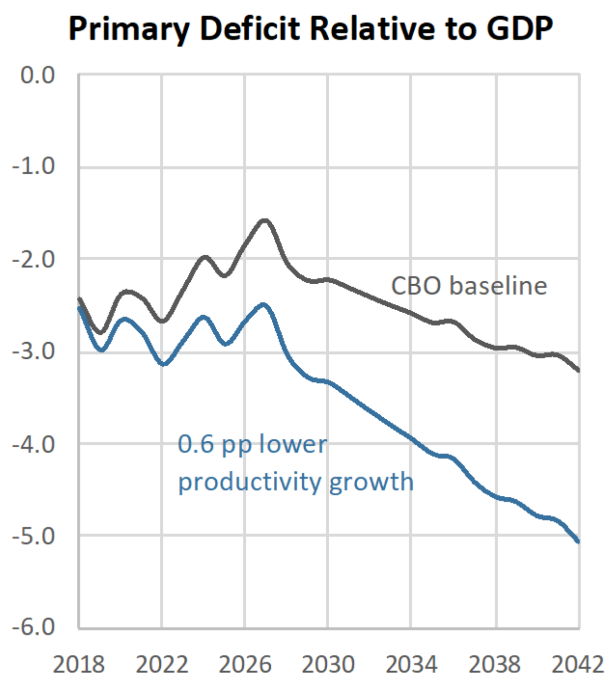
Why implications for fiscal policy?

Lower productivity growth matters for fiscal policy because it is associated with:

- Larger budget deficits
- Lower wage growth
- Lower interest rates

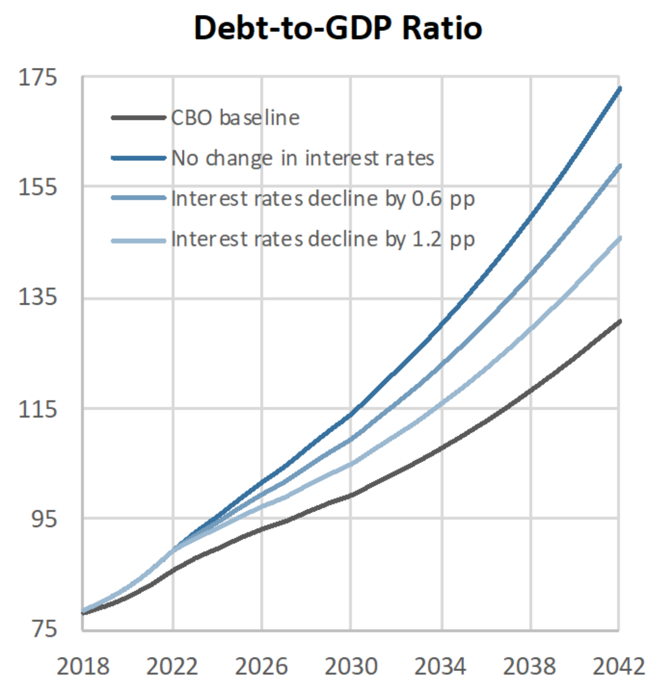
Larger budget deficits: Results from Sheiner

Lower productivity growth aggravates rise in US primary deficit



Data from Sheiner (2019)

With effect on debt-to-GDP depending on how much interest rates fall



Data from Sheiner (2019)

Implications for fiscal policy (taking lower productivity growth as a given)

Larger budget deficits:

- Recent research (e.g. Blanchard, 2019) arguing debt has small costs given current low interest rates
- Still, D/GDP can't rise infinitely—so lower productivity growth means **we will need to raise more tax revenue than we otherwise would** (discretionary spending already too squeezed to make big cuts)
- Also increases likelihood of cuts to income support and health care programs for older Americans, implying **more need for retirement savings incentives**

Implications for fiscal policy (taking lower productivity growth as a given)

Lower wage growth:

- Likely to lead to further declines in labor force participation for working-age Americans
- Heightens **need for more fiscal incentives to wo**rk (e.g. expanded EITC, subsidies for child care)

Lower interest rates:

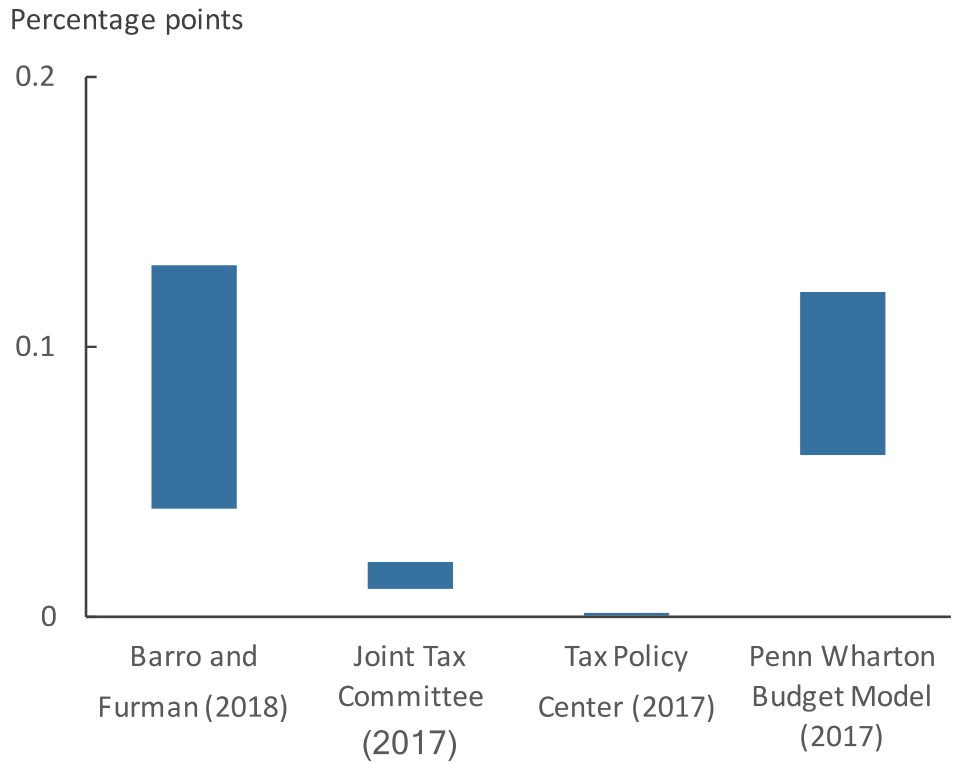
- Further limits scope for conventional monetary policy
- Given uncertain political will to use discretionary countercyclical fiscal policy, bolsters the case for putting **more and better automatic stabilizers** in place

Can we change fiscal policy in ways that boost productivity?

Truly pro-growth tax reform as well as investments in infrastructure, education, and research could make a material difference

But, experience with 2017 Tax Act and lack of action on infrastructure suggest that making such changes is hard politically

Estimated Effect of 2017 Tax Act on 2017-2027 Annual GDP Growth *Including Fiscal Stimulus Effects*



Note. Bars depict the range of estimates offered by these sources.