

Fiscal Policy and Economic Growth

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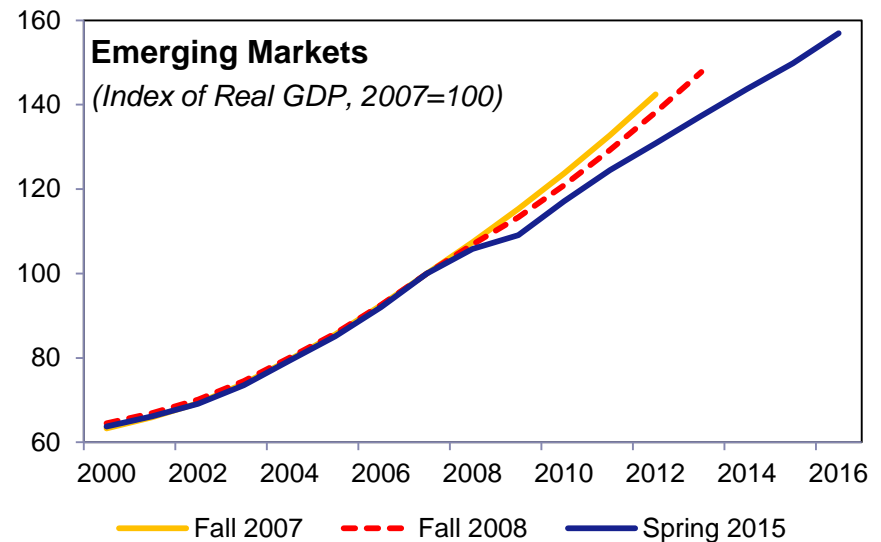
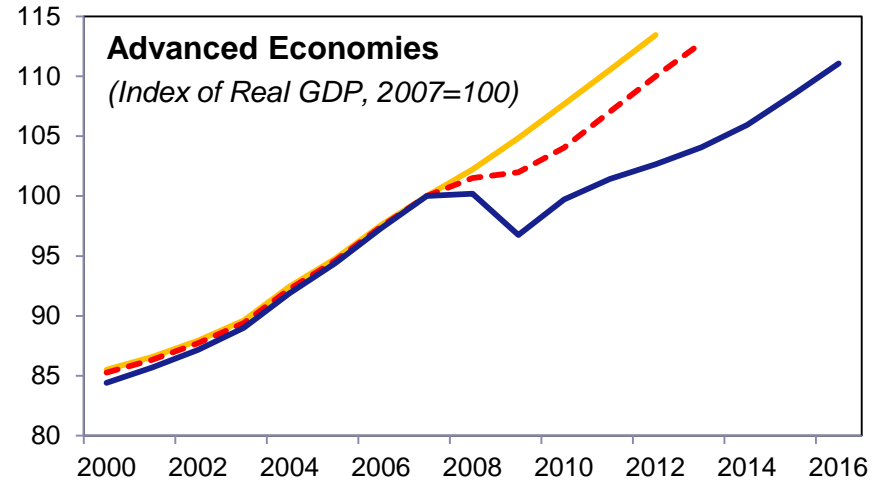
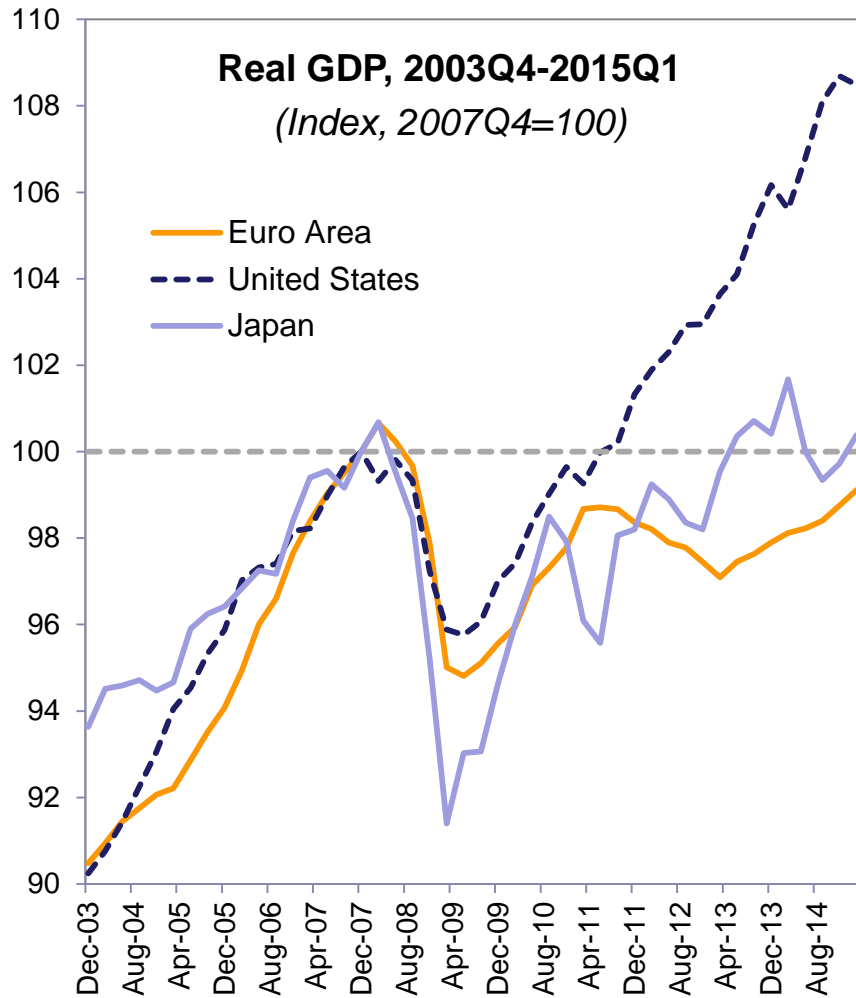
Peterson Institute for International Economics

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- The study draws on an extensive review of the literature and a three-pronged analytical approach:
 - **Nine in-depth country studies**
 - **Analysis of 146 growth acceleration episodes in 112 countries**
 - **Model simulations**
- **Country studies apply a novel statistical technique (the synthetic control method); and cover a diverse set of cases.**
- **Based on these complementary techniques we try to infer the ingredients of a successful fiscal reform strategy.**

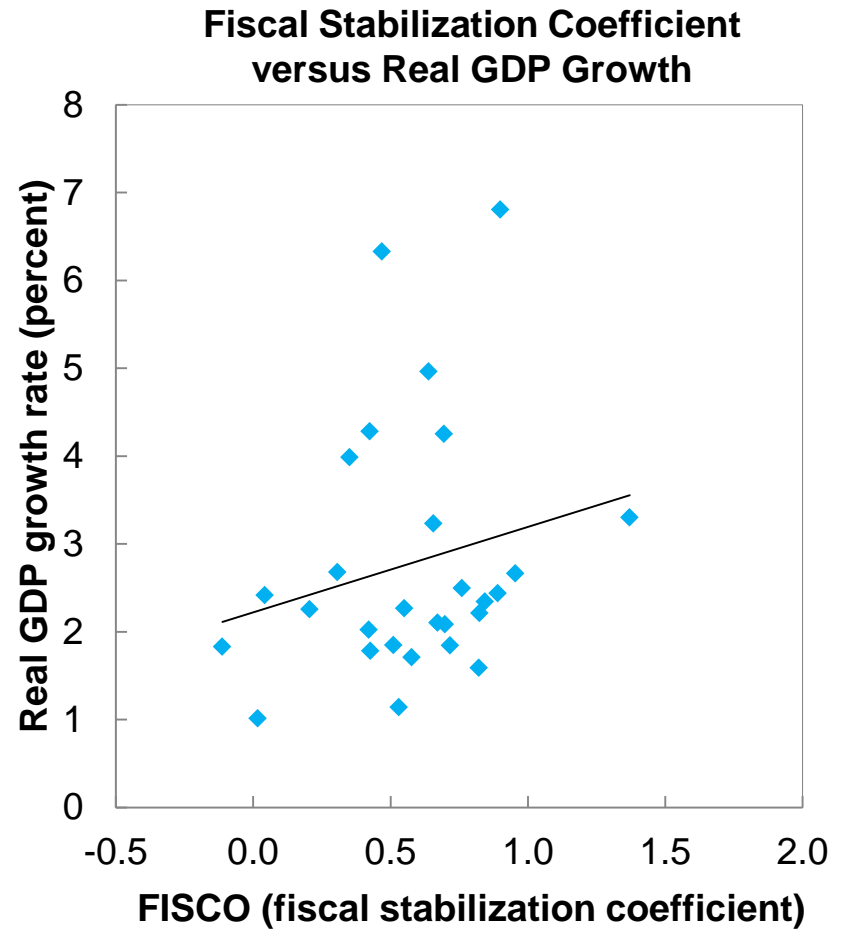
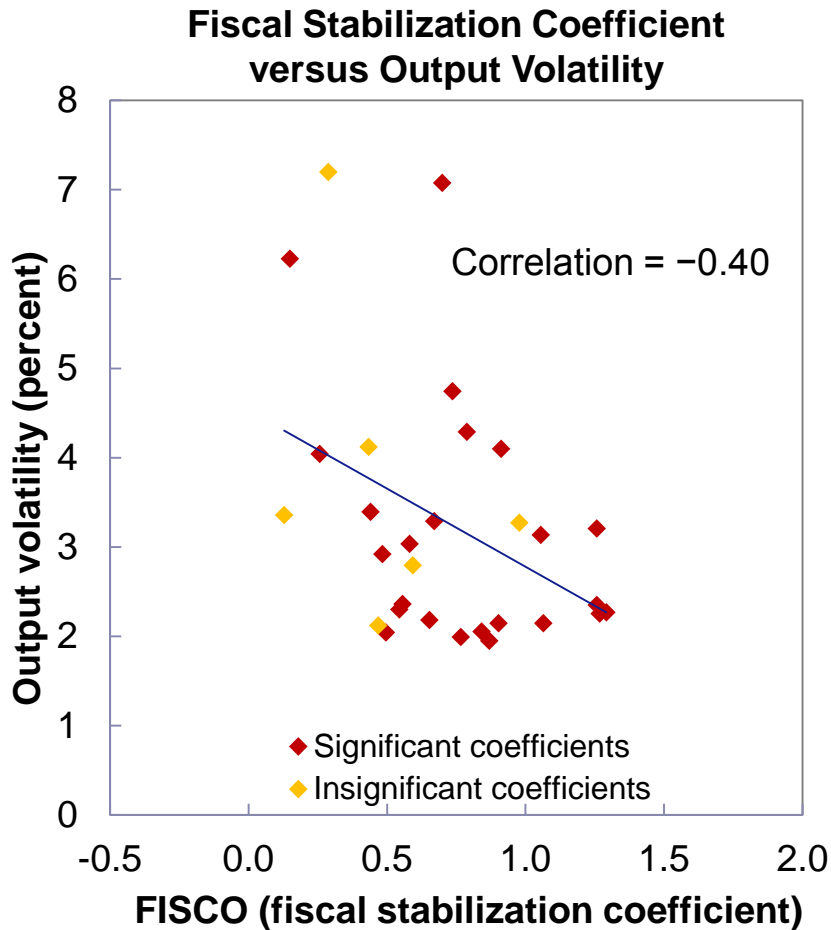
The global recovery remains weak and potential growth estimates have fallen



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

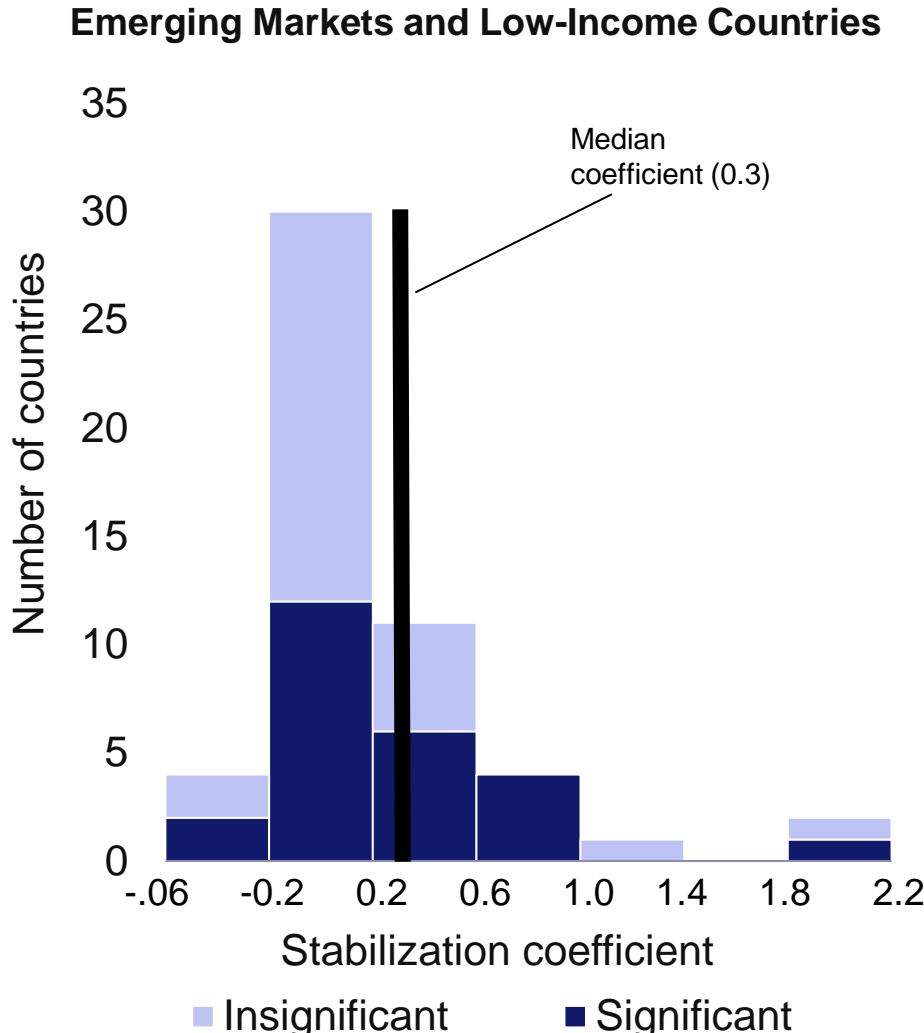
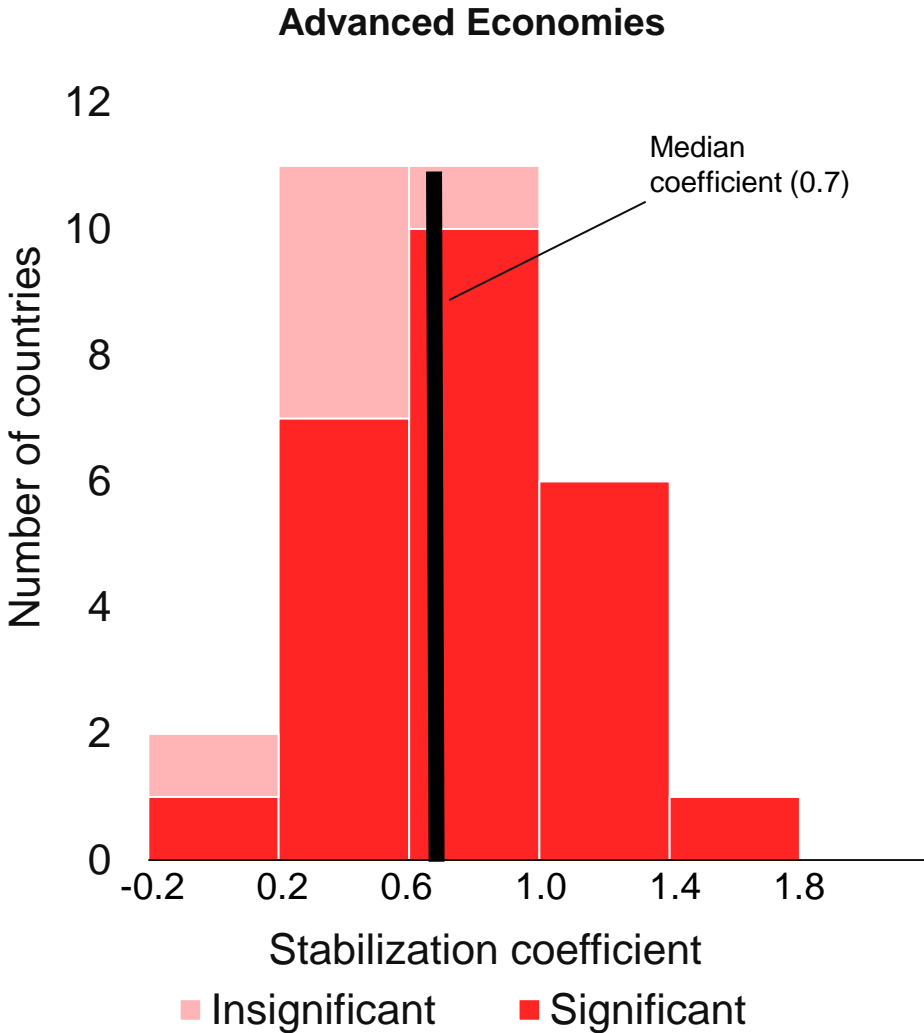
Fiscal stabilization is associated with lower output volatility and higher medium-term growth

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



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

Fiscal stabilization is more widespread in advanced economies



The paper analyses four key transmission channels of structural fiscal policies to growth

Labor
supply

Human
capital

Physical
capital

Innovation

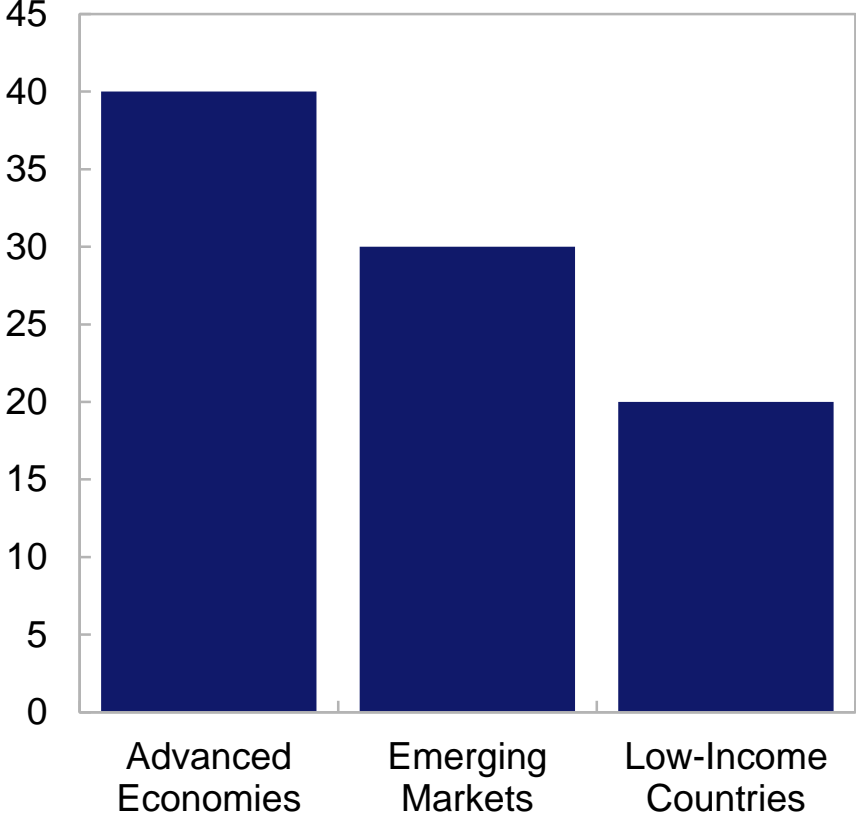


There is a broad menu of growth-friendly fiscal reform options

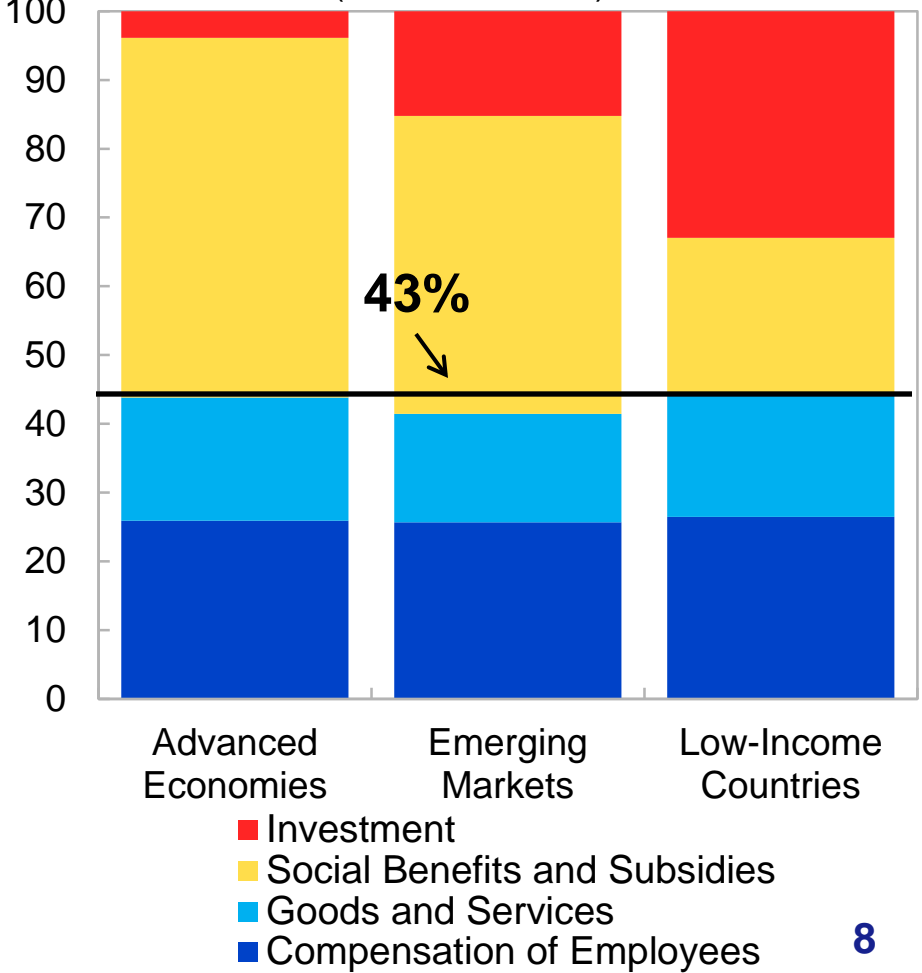
- Structural fiscal reforms can help build sound, growth-friendly, fiscal institutions.
- Both tax and expenditure policies can be made more growth-friendly.
 - **Labor supply:** Improving the design of labor taxes and social benefits strengthens work incentives.
 - **Human capital:** More equitable 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.

Example 1: Improve efficiency

Public Expenditure, 2014
(Percent of GDP)

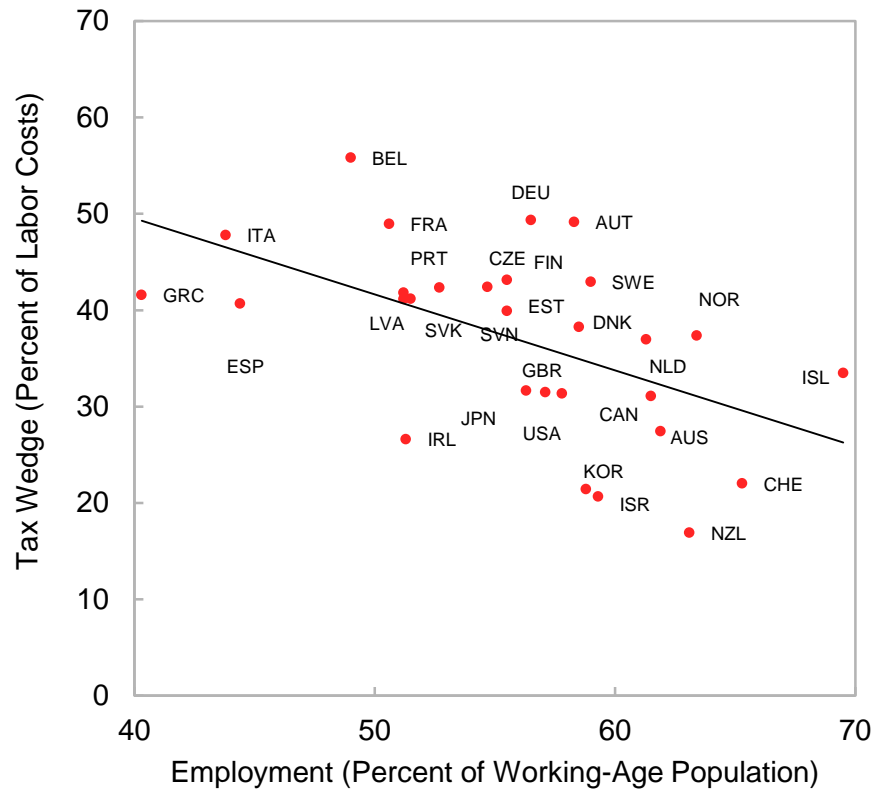


Public Expenditure Composition, 2007-2013
(Percent of total)

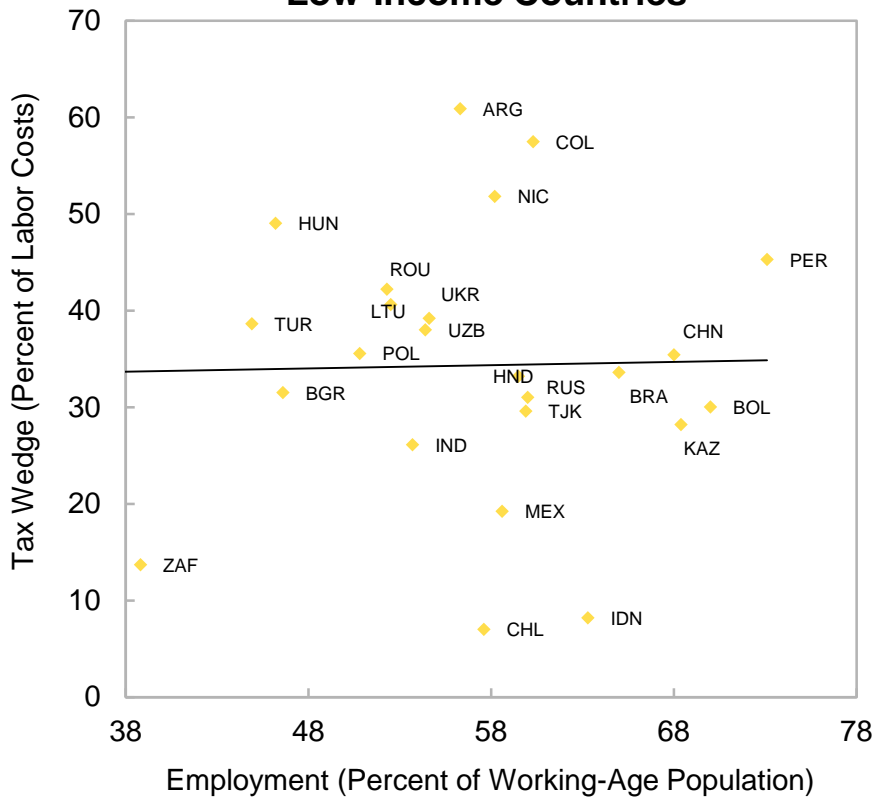


Example 2: Strengthen work incentives

Advanced Economies



Emerging Markets and Low-Income Countries

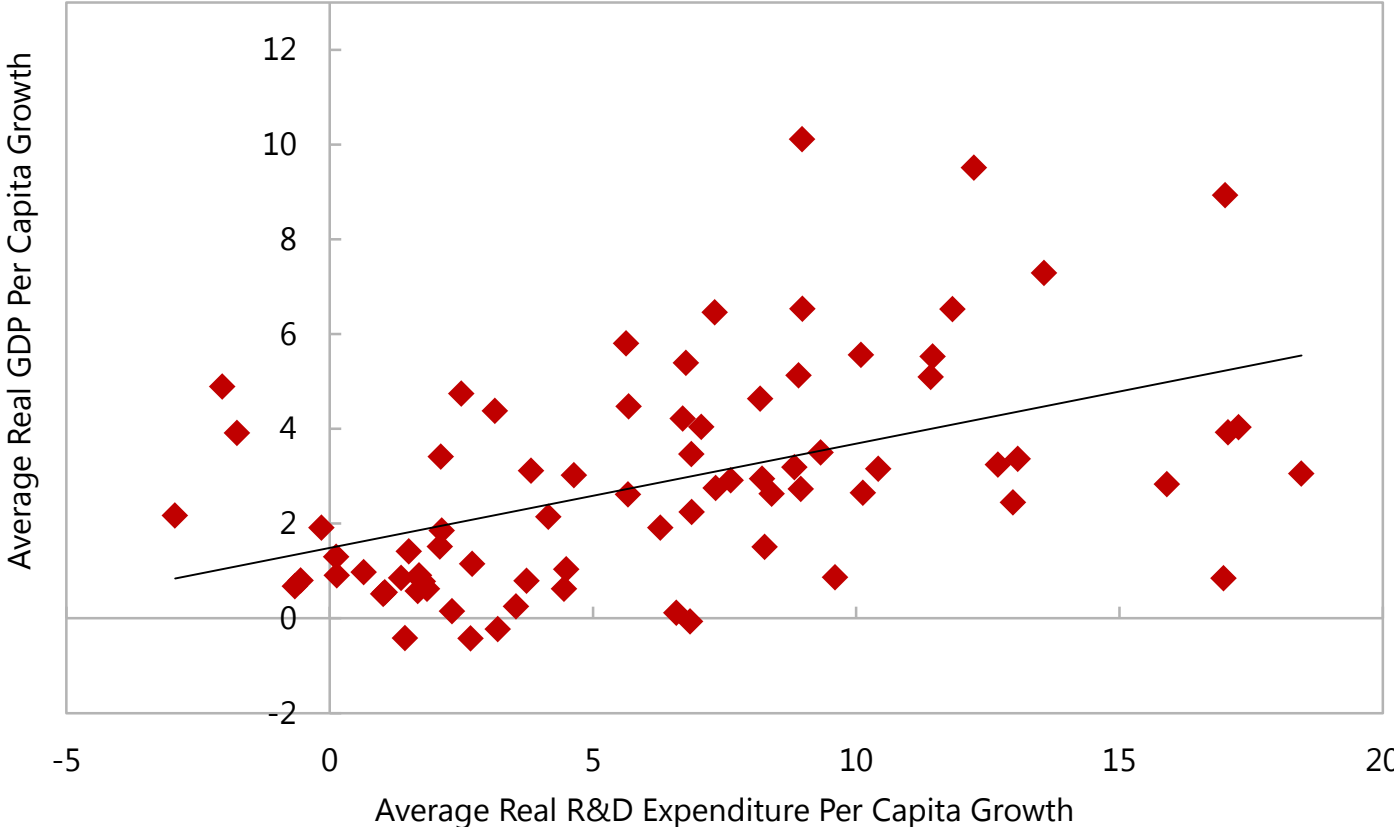


Source: IMF staff calculations.

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

Example 3: Encourage private R&D

R&D Expenditure and Growth, 2001-2012

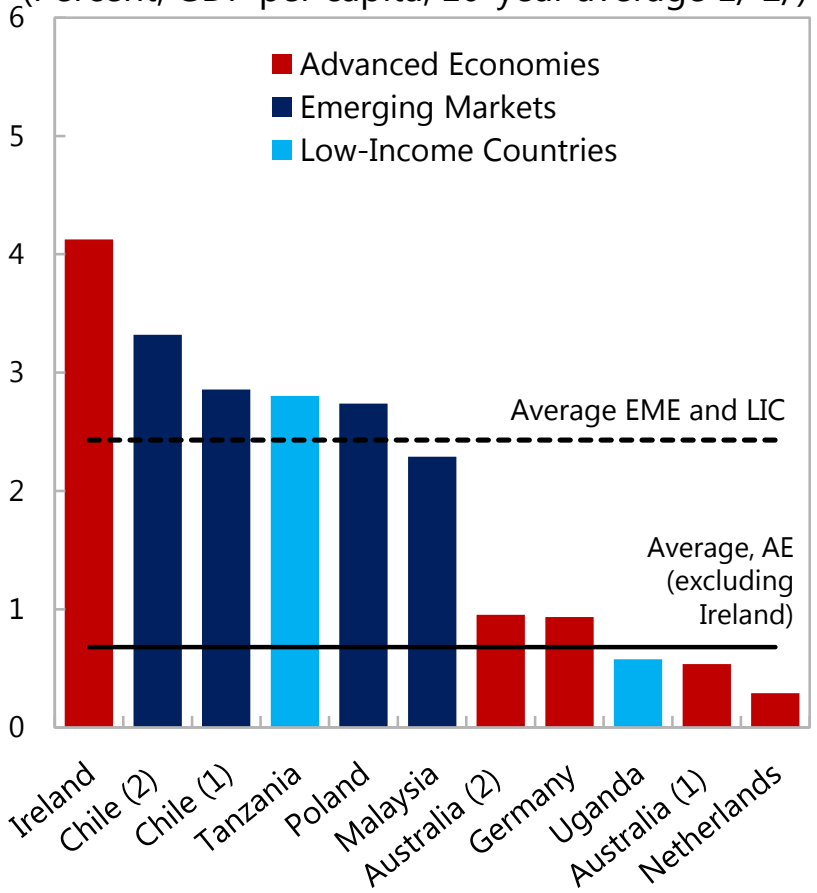


Source: World Development Indicators
 Note: Excludes countries with fewer than five observations during the considered period.

Evidence from Country Studies

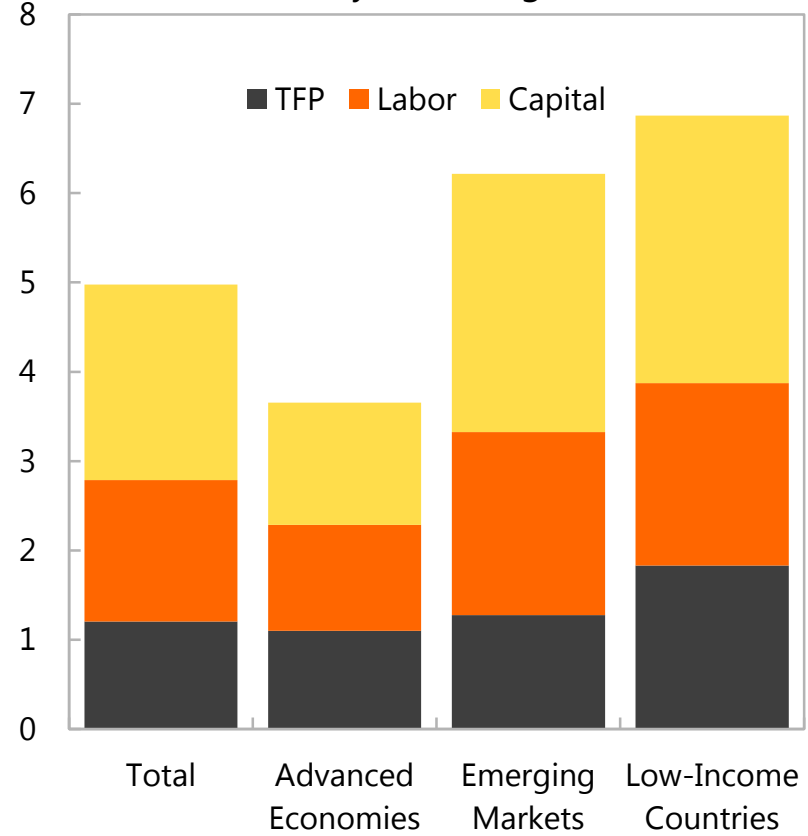
Estimated Growth Gain

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



Long-Term Growth Post-Reform

(Percent, GDP, 10-year average)



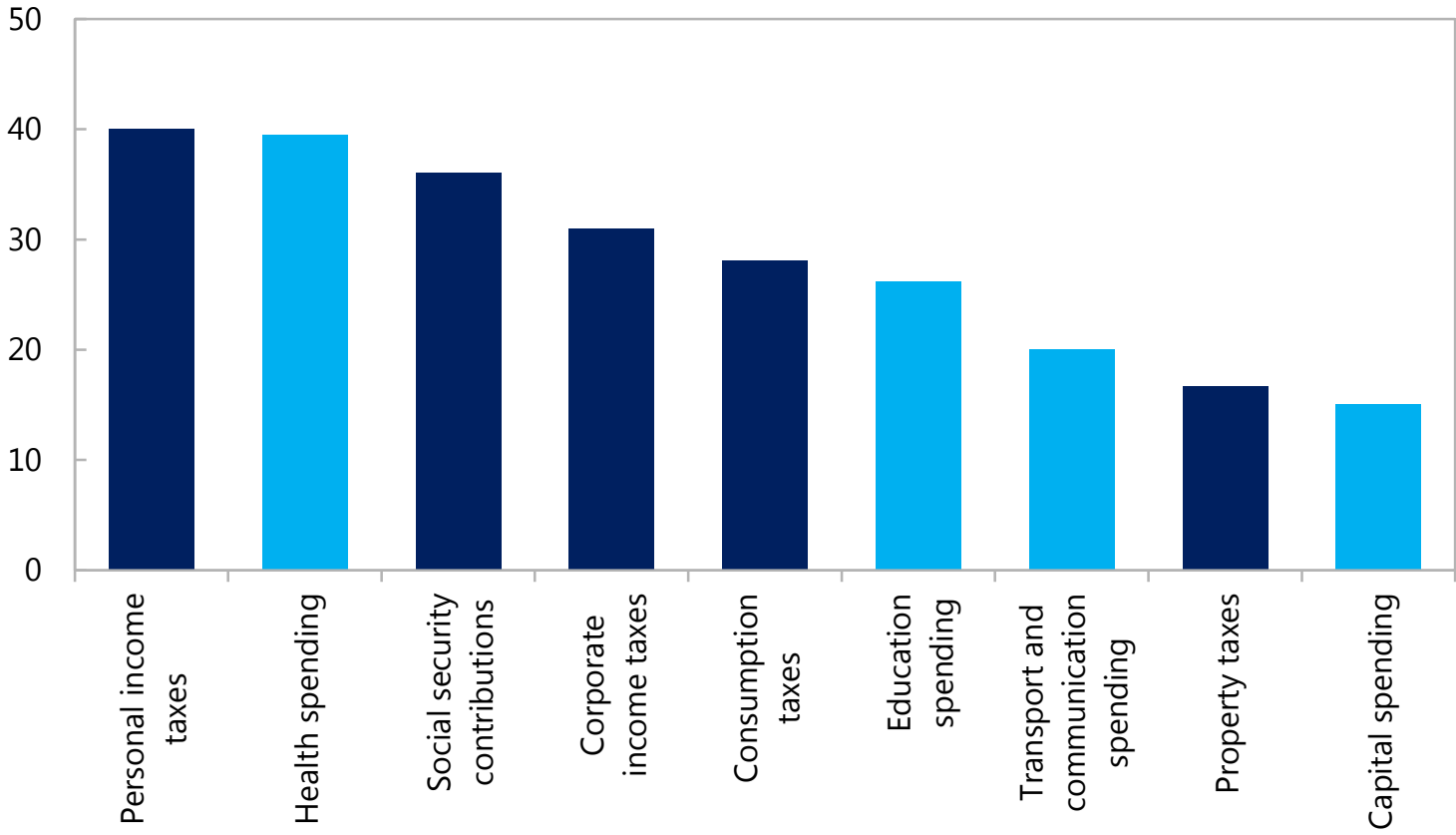
Source: IMF staff calculations.

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).

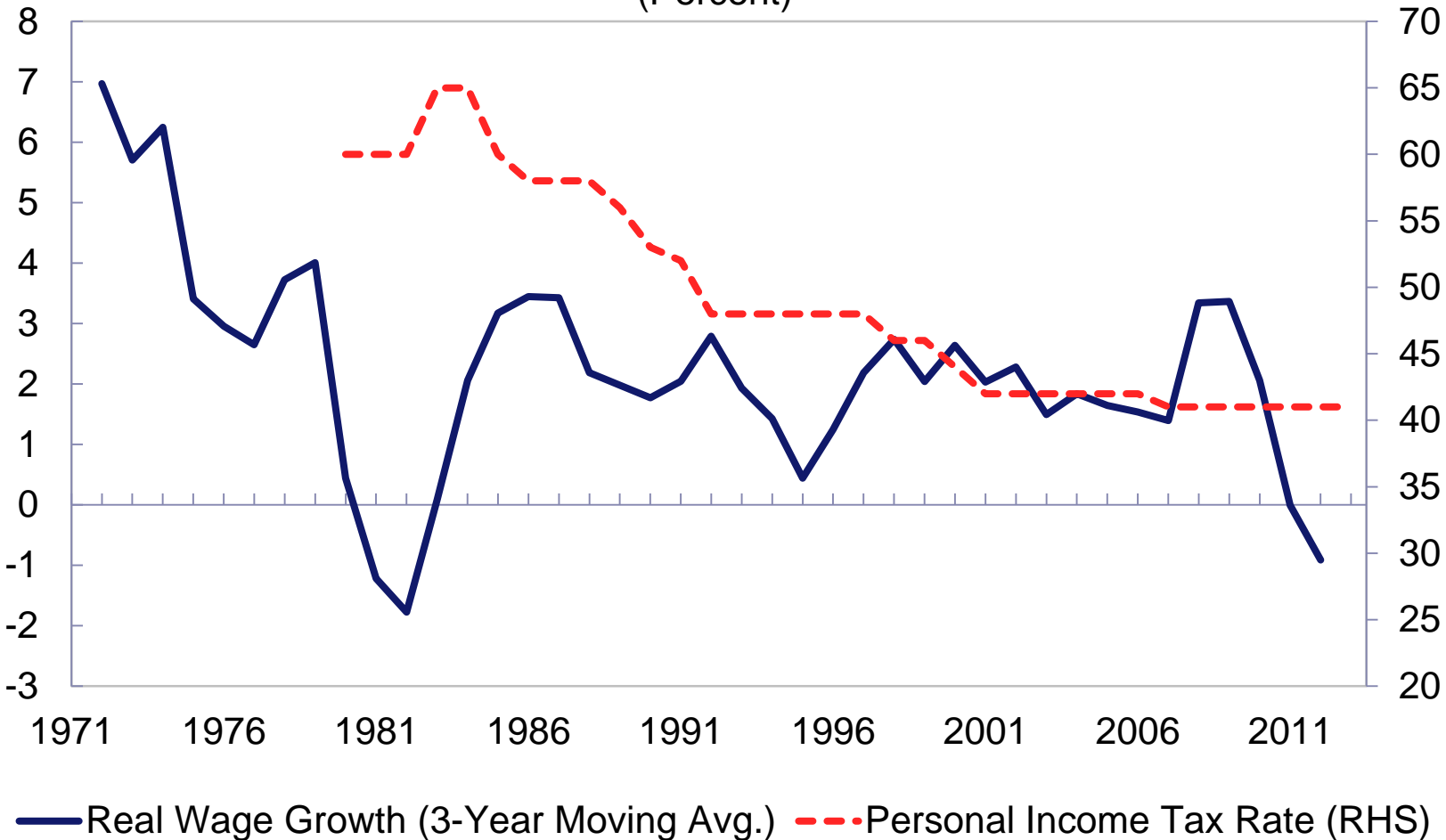
Evidence from Growth Acceleration Episodes

Fiscal Reforms and Conditional Probability of Growth Accelerations (Percent)



Design Matters: Complementary reforms help maximize growth gains

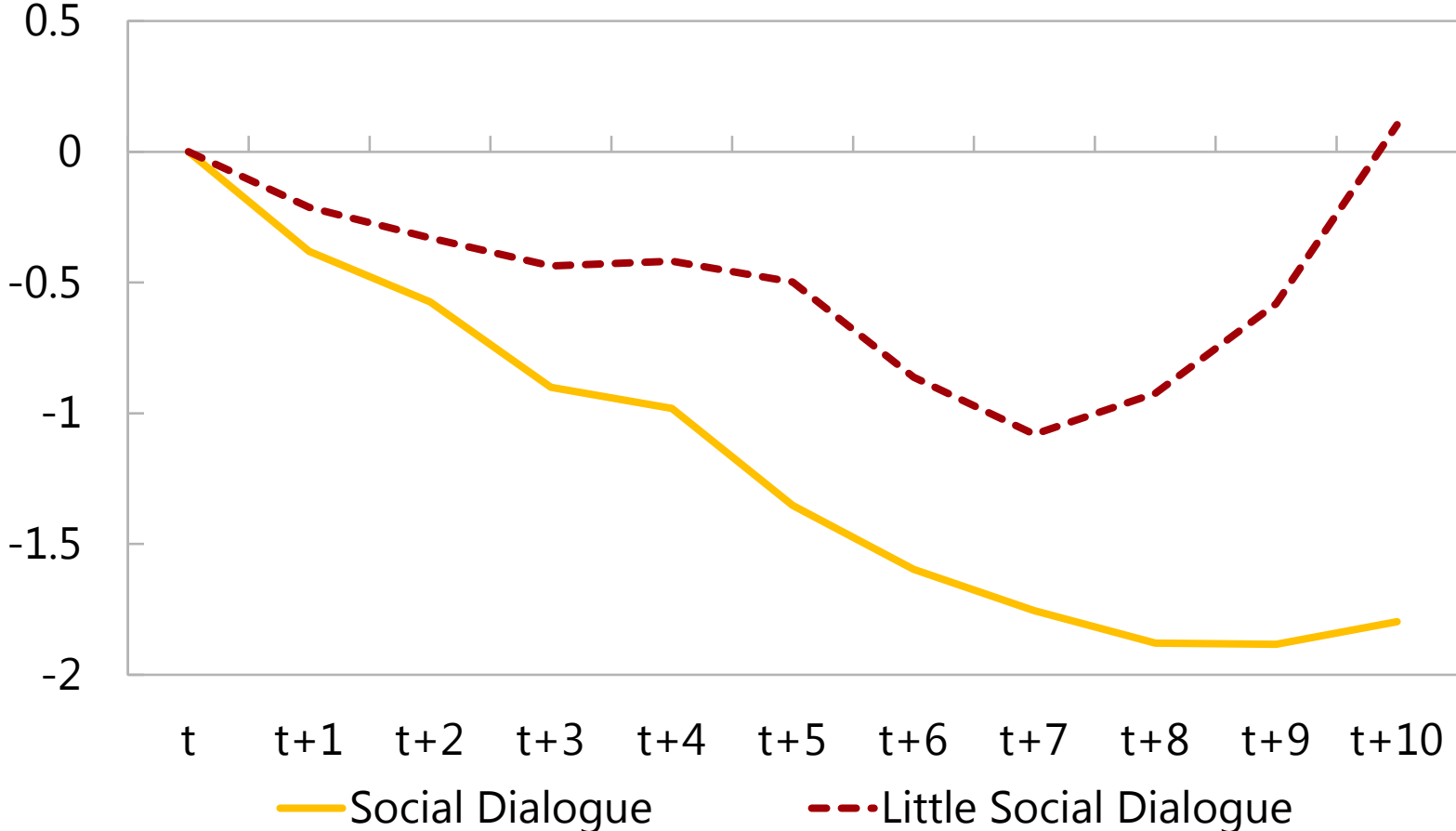
Ireland: Tax Cuts and Wage Moderation
(Percent)



Source: IMF staff calculations.

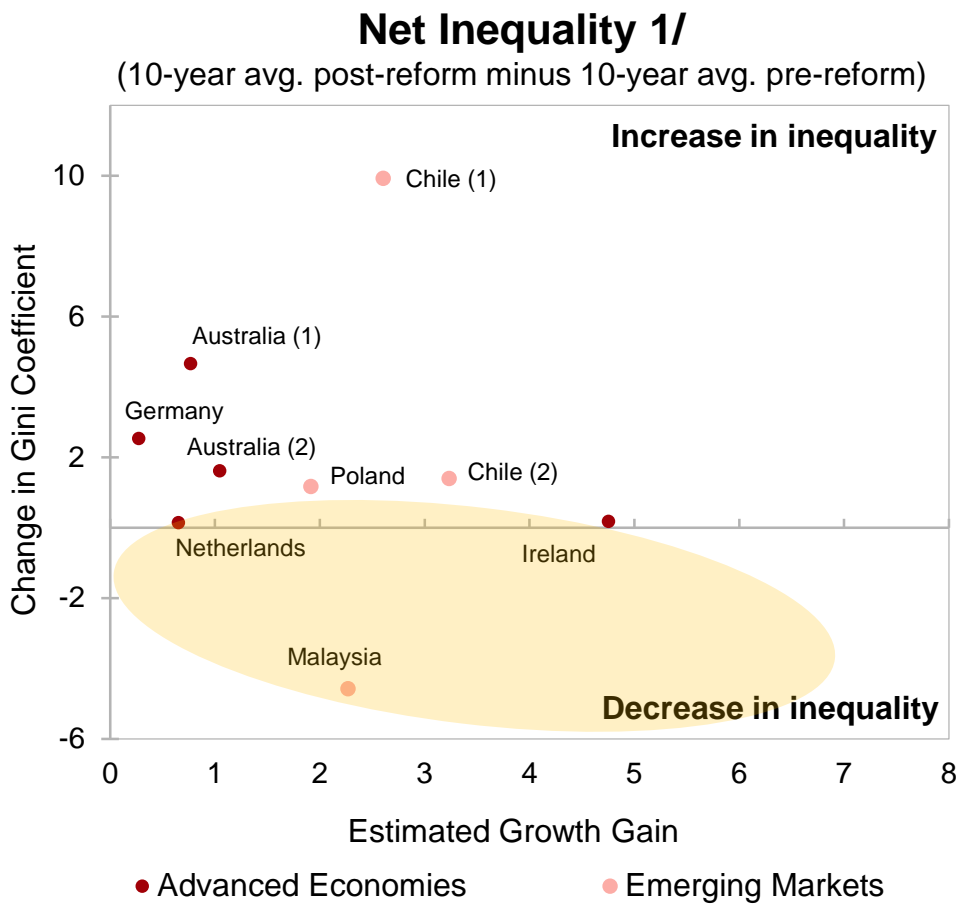
Design Matters: Public support helps deepen and sustain reform efforts

Cumulative Change in the Public Wage Bill
(Percent of GDP)



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 reforms make a difference for long-term growth:**
 - **Evidence shows that growth increased by $\frac{3}{4}$ 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!