Fiscal Policy and Structural Reforms

Vitor Gaspar

Director, Fiscal Affairs Department

International Monetary Fund

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"Structural reforms: Dynamic growth impact and policy challenges"

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Outline of the Presentation

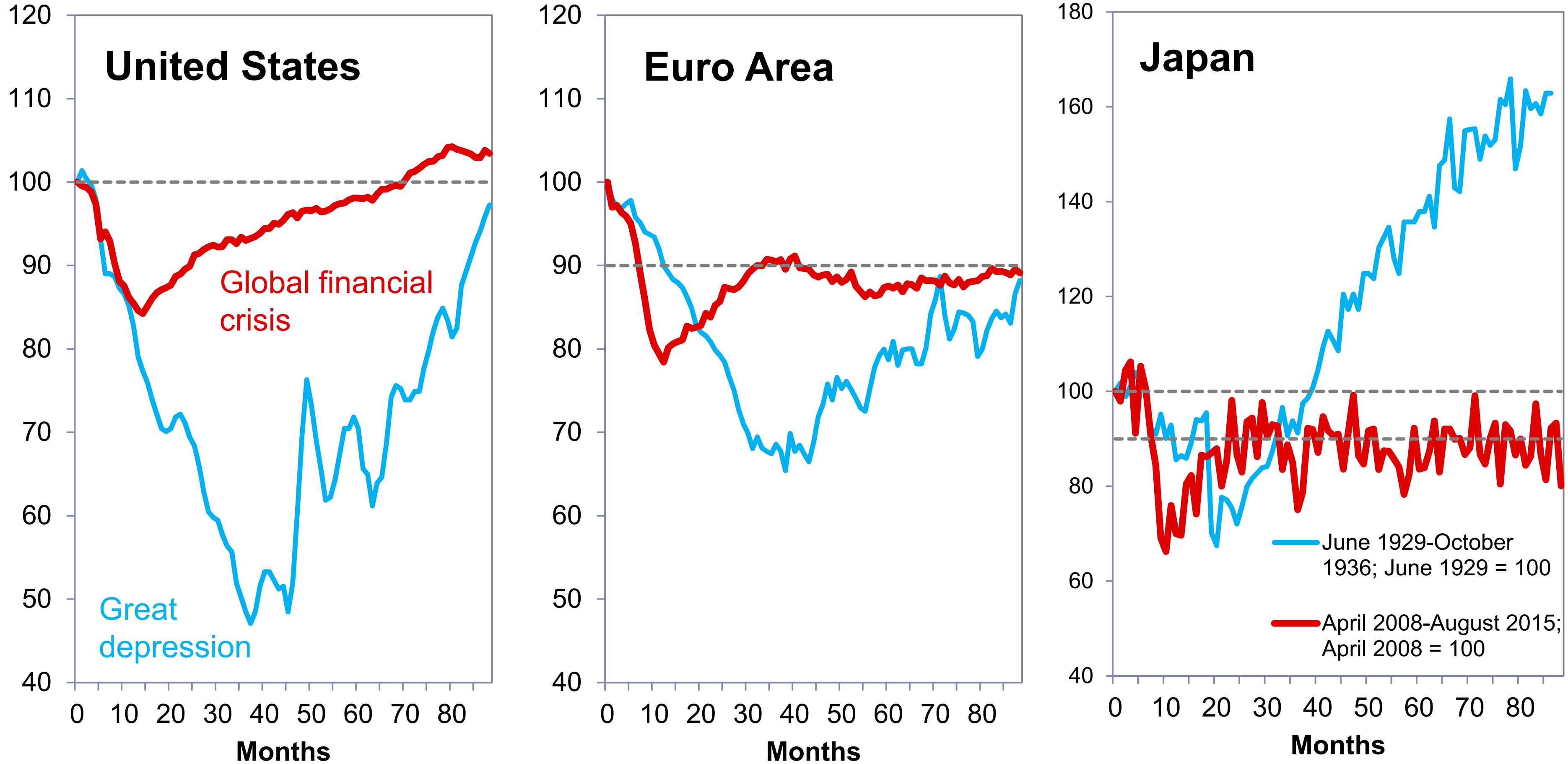
1. **Risks in the Macroeconomic Landscape**

2. **Coherent, Comprehensive and Coordinated Approach to Economic Policy**

3. **Conclusion**

1. Risks in the Macroeconomic Landscape
Global Financial Crisis vs. the Great Depression

Industrial production index

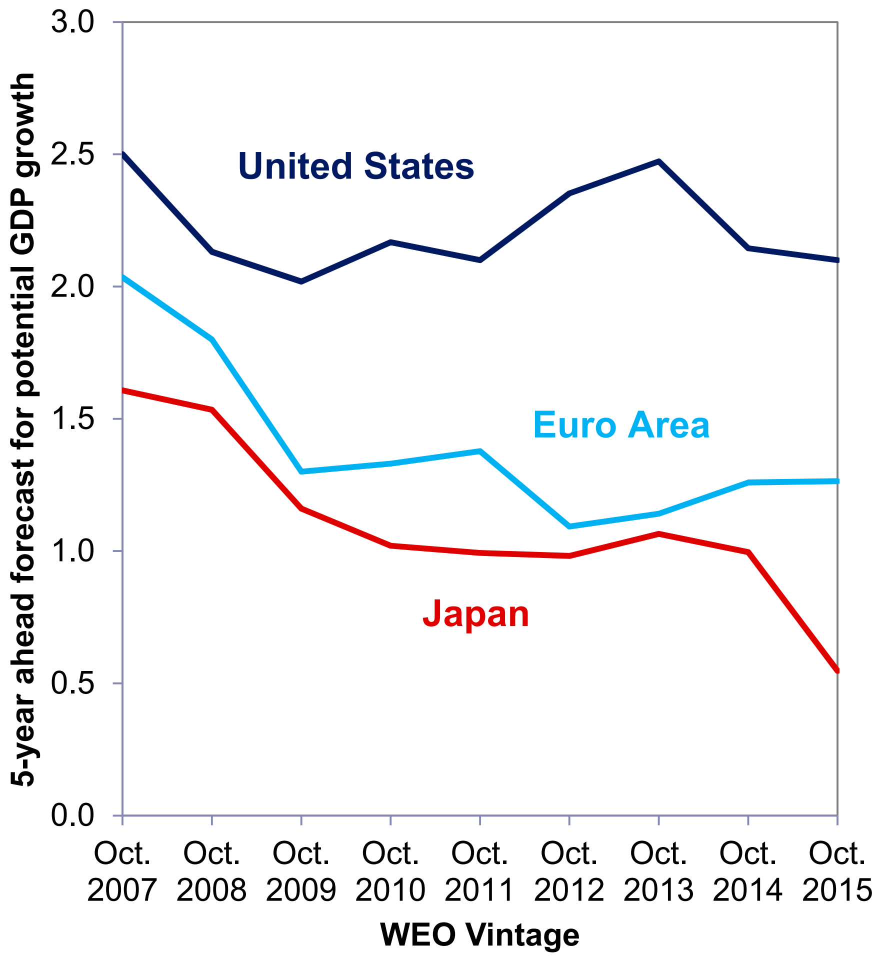


Note: For the Euro Area, the 1929 to 1936 series corresponds to the average across France, Germany, and Italy.

Source: Eichengreen, B. and K.H. O'Rourke (2010) "What do the new data tell us?" VoxEU.org , 08 March; League of Nations Statistical Yearbooks 1934-38 made digitally available by Northwestern University Library at http://digital.library.northwestern.edu/league/stat.html ; Federal Reserve Bank of St. Louis; Haver Analytics and IMF staff estimates.

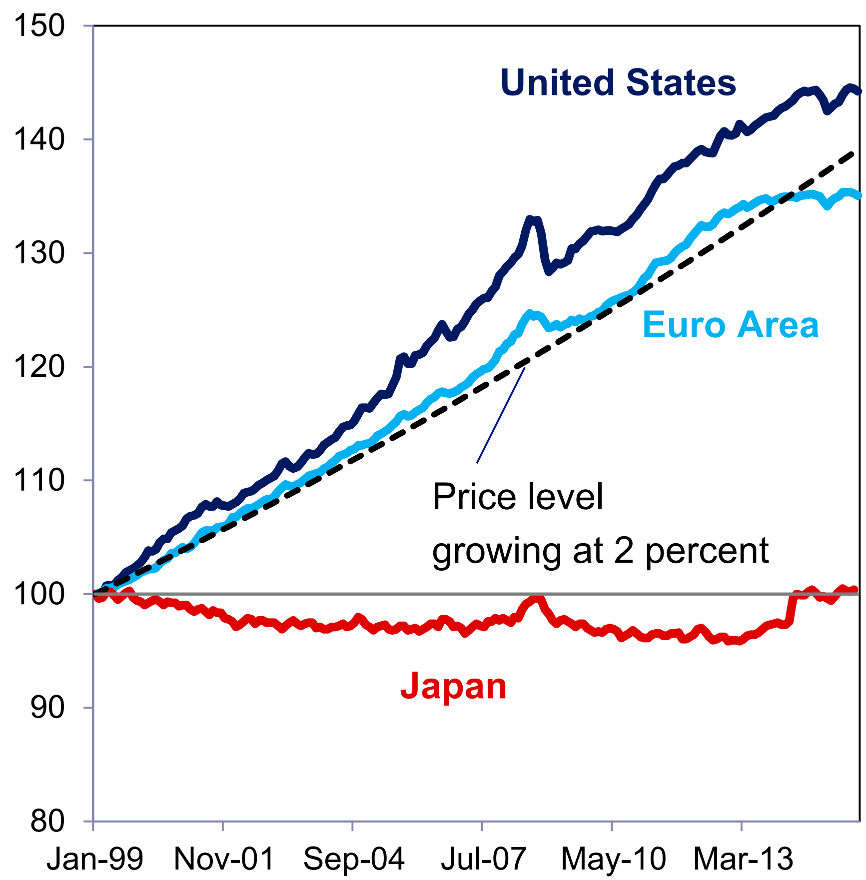
1. Risks in the Macroeconomic Landscape
Low growth expectations, low inflation for too long

5 year Ahead WEO Forecast for Potential GDP Growth *(Percent)*



Source: IMF *World Economic Outlook*

Price Level Path, Jan 1999–Sept 2015
(Index, January 1999=100)

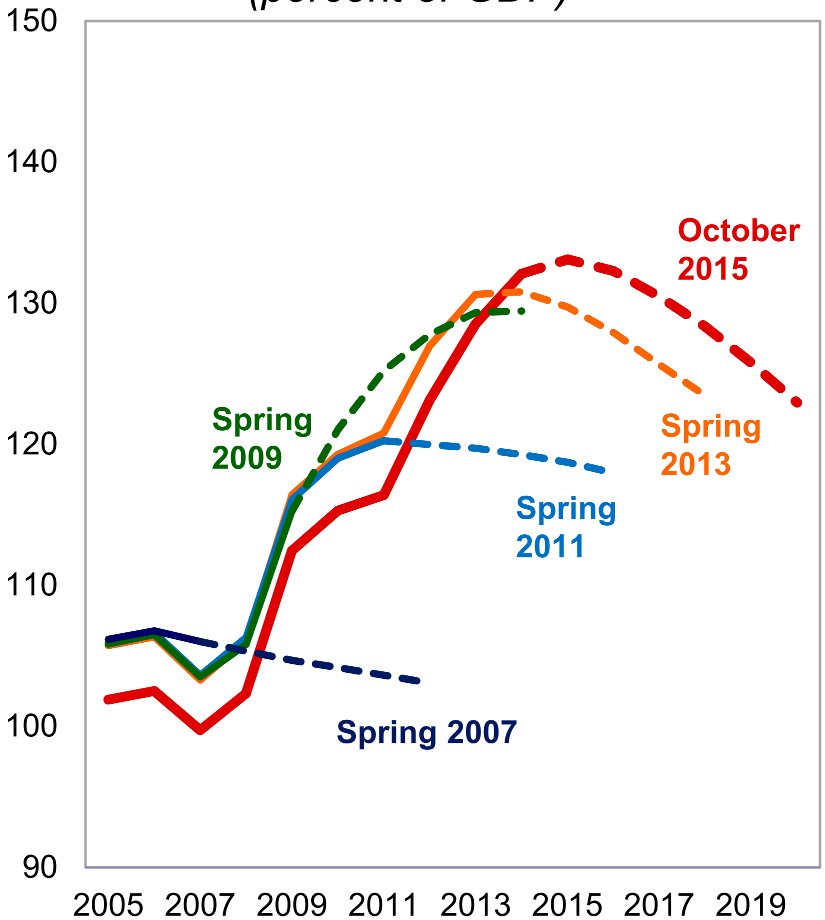


Source: Haver Analytics. Monthly data. Latest observation: September 2015 for the United States and Euro Area, August 2015 for Japan.

1. Risks in the Macroeconomic Landscape
Low nominal growth is adversely affecting public finances

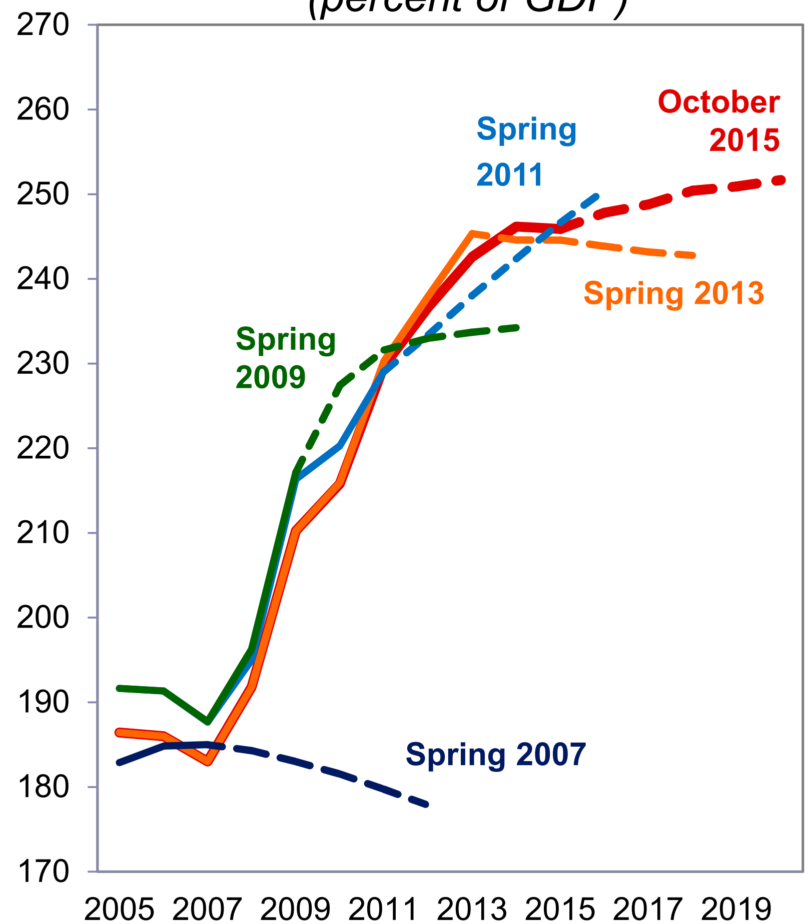
Italy: Revisions to General Government Gross Debt, 2005-2020

(percent of GDP)



Japan: Revisions to General Government Gross Debt, 2005-2020

(percent of GDP)

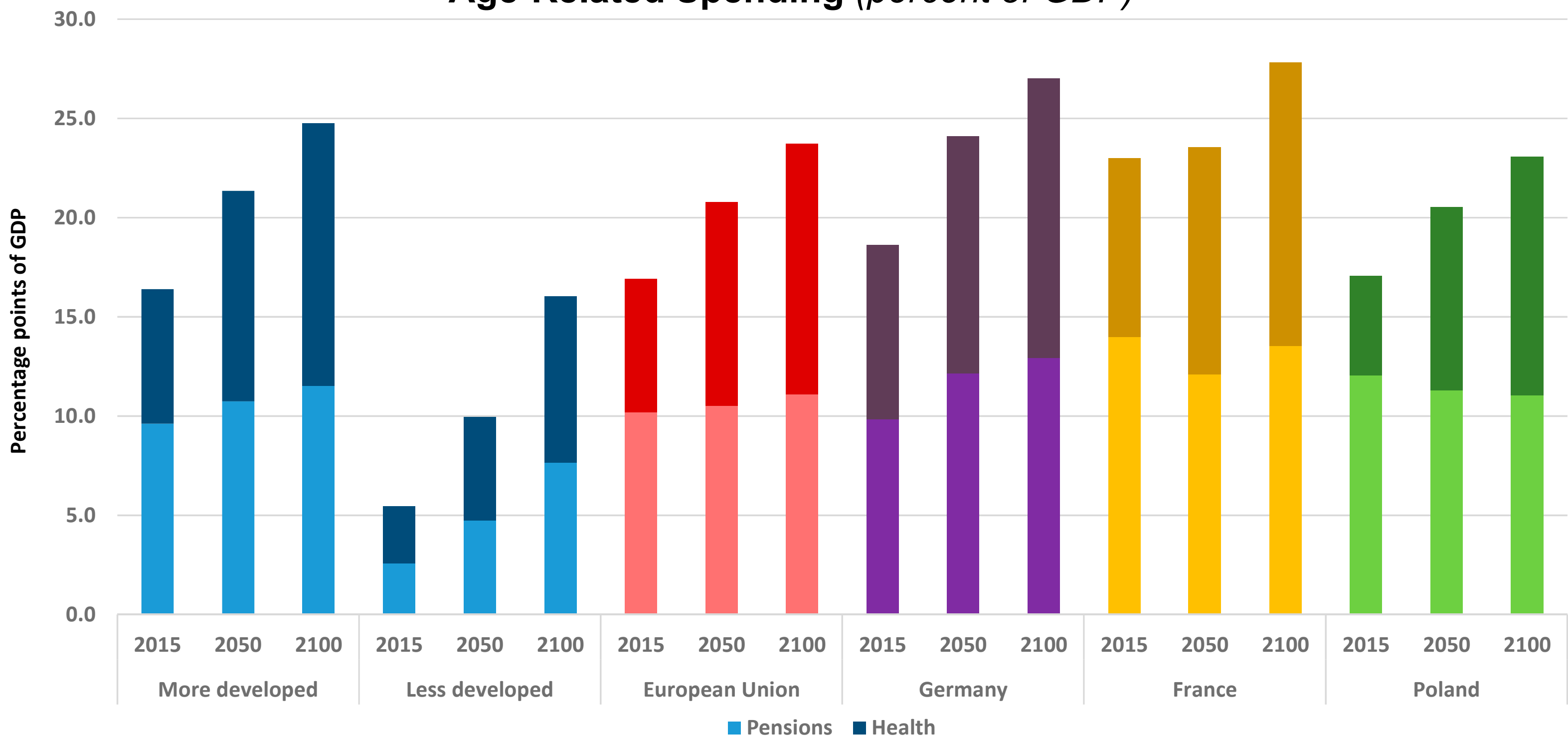


Sources: IMF, *Fiscal Monitor* October 2015 and *World Economic Outlook* October 2015

1. Risks in the Macroeconomic Landscape
Long-term trends: Aging, shrinking populations

- **Population aging will have a large direct impact on public spending**
- **Demographic changes will also affect fiscal sustainability through their impact on growth**

Age-Related Spending *(percent of GDP)*



Challenges

- **With interest rate policy constrained, unconventional policy is followed to achieve price stability**
  - But monetary transmission mechanism becomes more uncertain

- **Structural reforms can improve long-run prospects for employment and output**
  - But in some cases these have short-term costs (October 2014 Fiscal Monitor)
  - They are slow to implement, or slow to gain traction
  - May be deflationary (Eggertsson, 2013)

Support from Fiscal Policy

In some circumstances, *support from fiscal policy is needed*

1. Fiscal policy can serve as a backup to monetary policy

- **Makes demand management policies credible and effective**
- **Larger automatic stabilizers can reduce the likelihood of becoming constrained by the zero lower bound**

2. Structural fiscal reforms can make tax and expenditure policies more growth-friendly

3. Fiscal policy can encourage structural reform

- **Offsetting potential short term economic costs of reform**
- **Mitigating the distributive effects of structural reform**
- **Supporting demand to avoid deflationary pressures**

2. Coherent, Comprehensive, and Coordinated Approach to Economic Policy

Monetary

Unconventional monetary policy

+

Fiscal

Infrastructure investment; targeted transfers

+

Structural

Labor market; product market; tax system

Sustained and inclusive economic growth
CPI inflation at 2% over the medium term
Jobs creation

3. Conclusion

- **Macroeconomic stabilization policies need to be accompanied with structural policies to improve competitiveness and increase potential growth.**

- **Monetary and fiscal policies can be used to generate short-run gains.**

- **Demand management policies can support the implementation of structural reform policies, by offsetting their potential short term economic costs or mitigating their distributive effects.**

Thank You!