OECD ECONOMIC OUTLOOK

SPECIAL CHAPTER

Using fiscal levers to escape the low-growth trap

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OECD
BETTER POLICIES FOR BETTER LIVES

Key messages

Re-assessing fiscal space

- Increased in most OECD countries since 2014, as lower interest rates have dominated other factors.
- Reforms to entitlement programmes would create additional fiscal space.

Characterizing fiscal initiatives by OECD countries

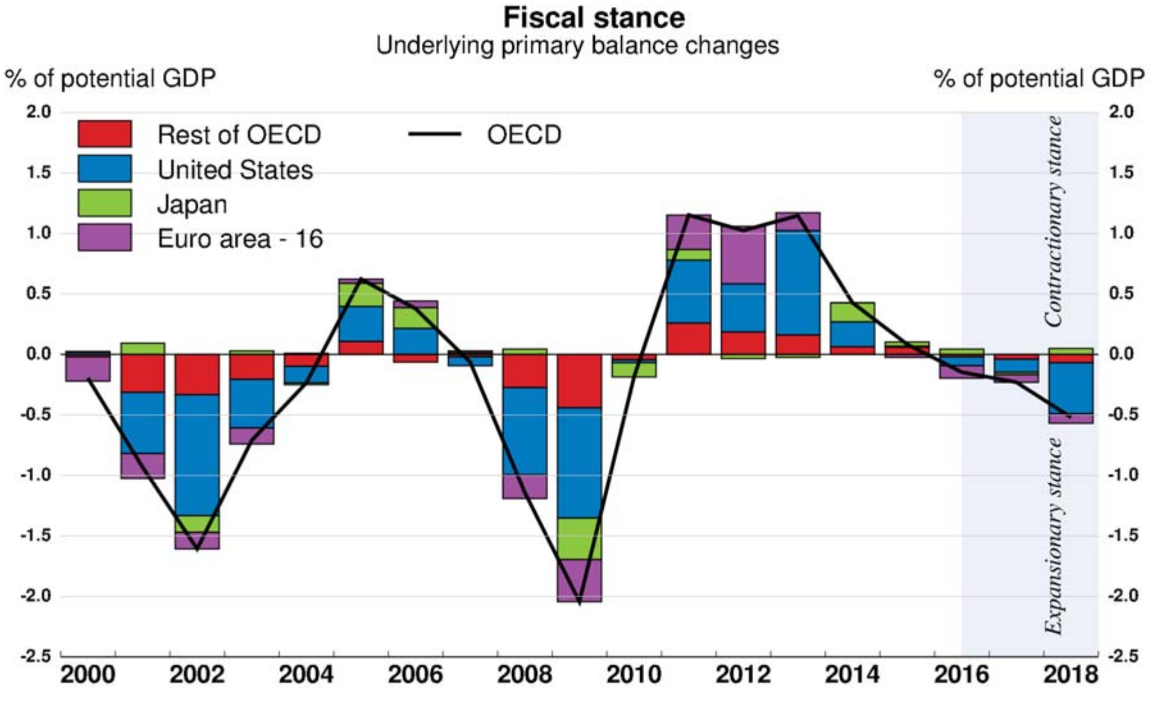
- ½ percentage point of GDP fiscal initiative, for three to four years on average
  - Debt-to-GDP ratio unchanged in the medium term
  - Average output gains of 0.4-0.6% in the first year
- Reprioritising spending in later years
  - Long-run output increasing to 2% in the large advanced economies
- Complementary structural reforms are crucial to get the most out of the fiscal initiative.

Comparing fiscal plans, OECD recommendations versus country plans

- In about 1/3 of the EO countries, OECD recommends more expansionary fiscal plans.

Re-assessing fiscal space

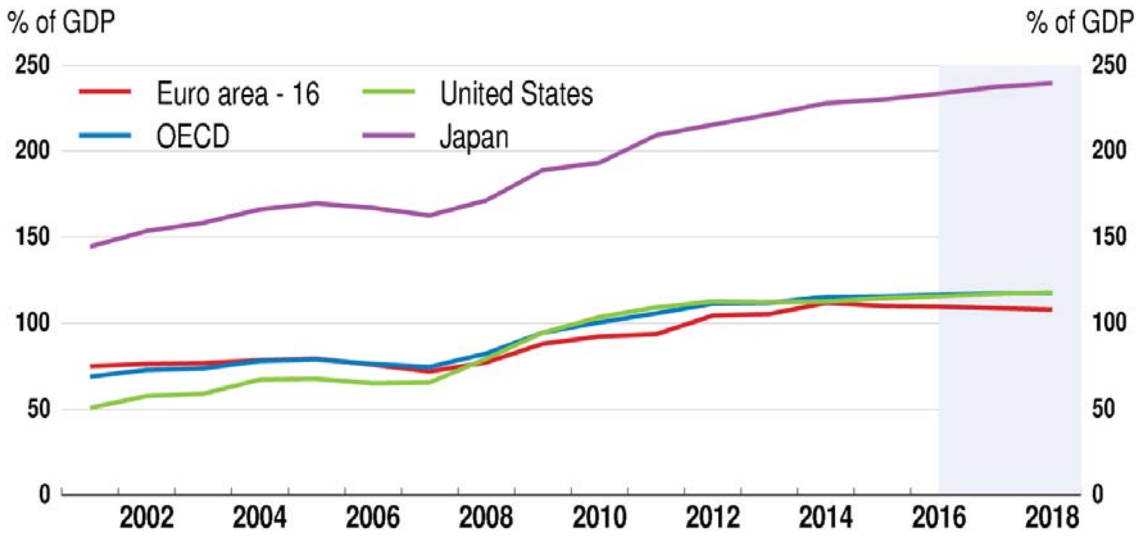
Fiscal policy has eased only recently



Source: OECD Economic Outlook 100 database.

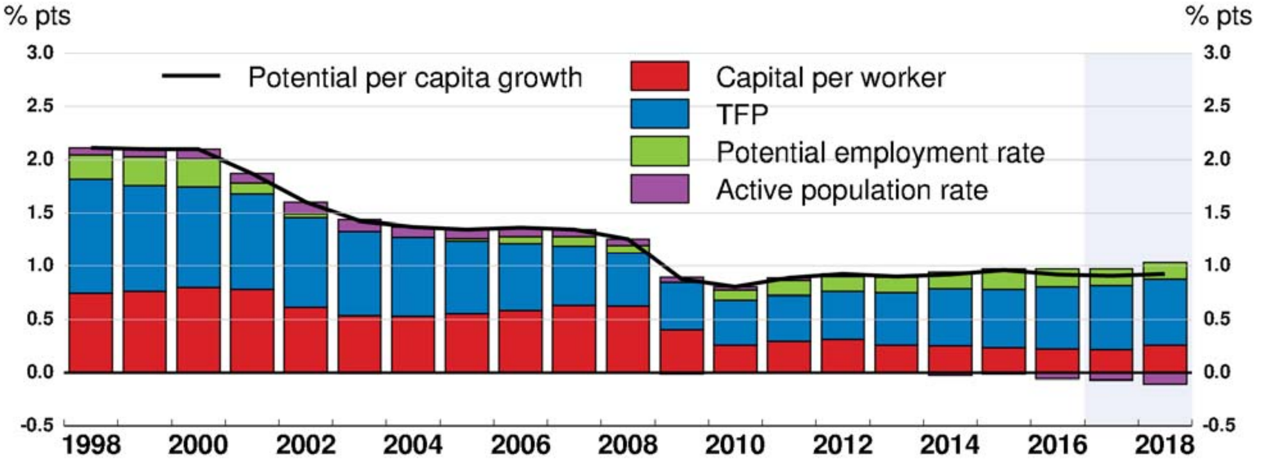
Public debt has stabilised in the United States and Europe

General government gross liabilities



Source: OECD Economic Outlook 100 database.

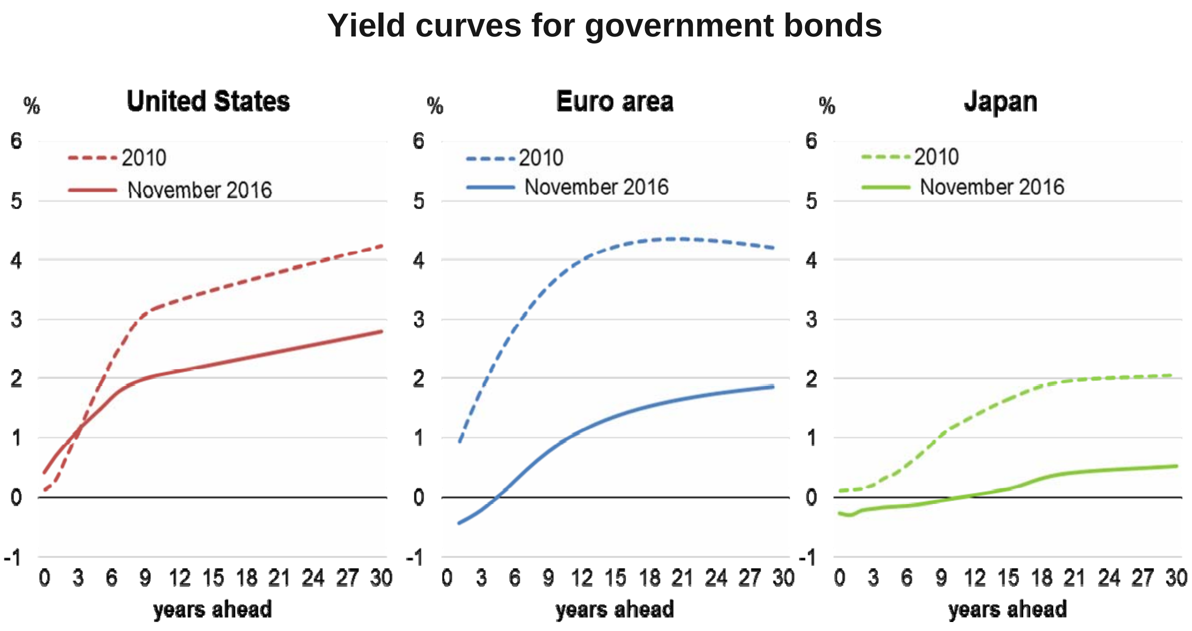
But potential output has slowed



Note: Potential output growth is in per cent and is computed with growth in Ireland in 2015 using gross value added at constant prices excluding foreign-owned multinational enterprise dominated sectors.

Source: OECD Economic Outlook 100 database.

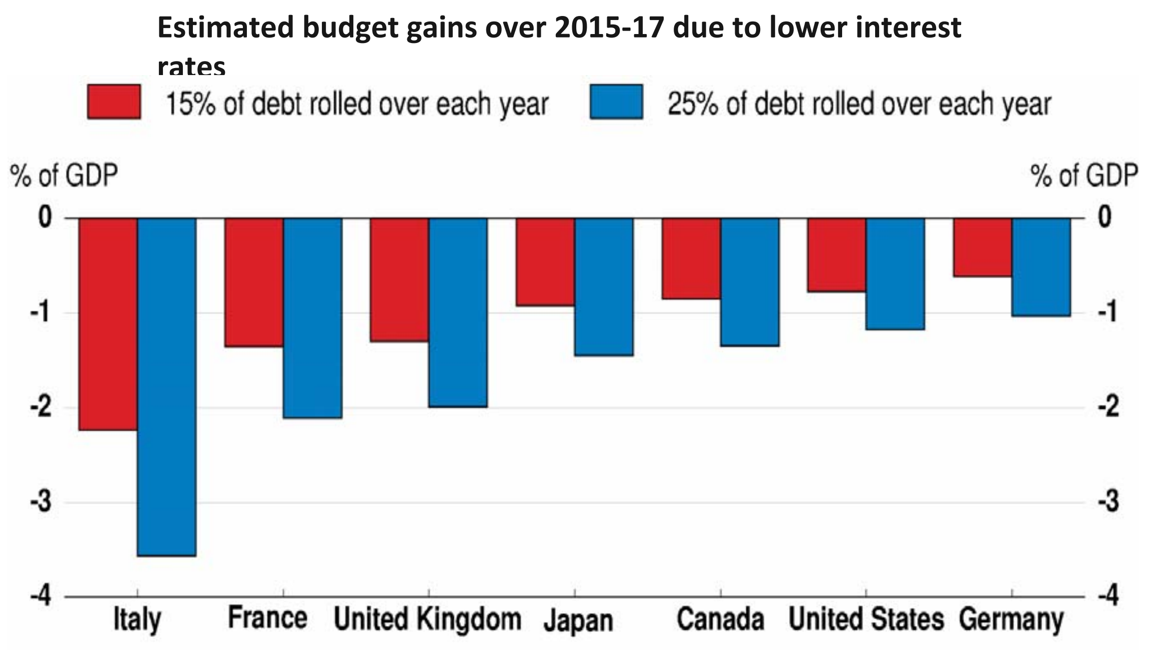
Interest rates are near record low levels…



Note: Bond yields are averages for 2010 and for 1st through 21st November 2016, respectively.

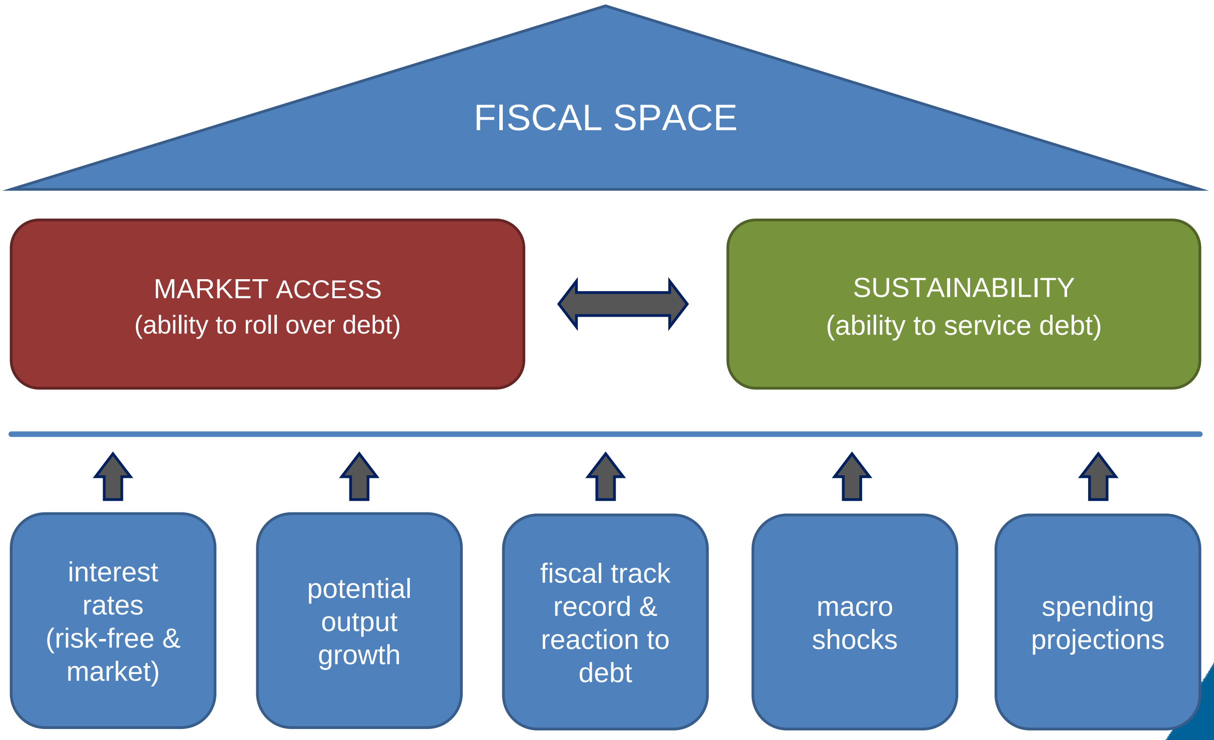
Source: Bloomberg.

… leading to fall in interest payments



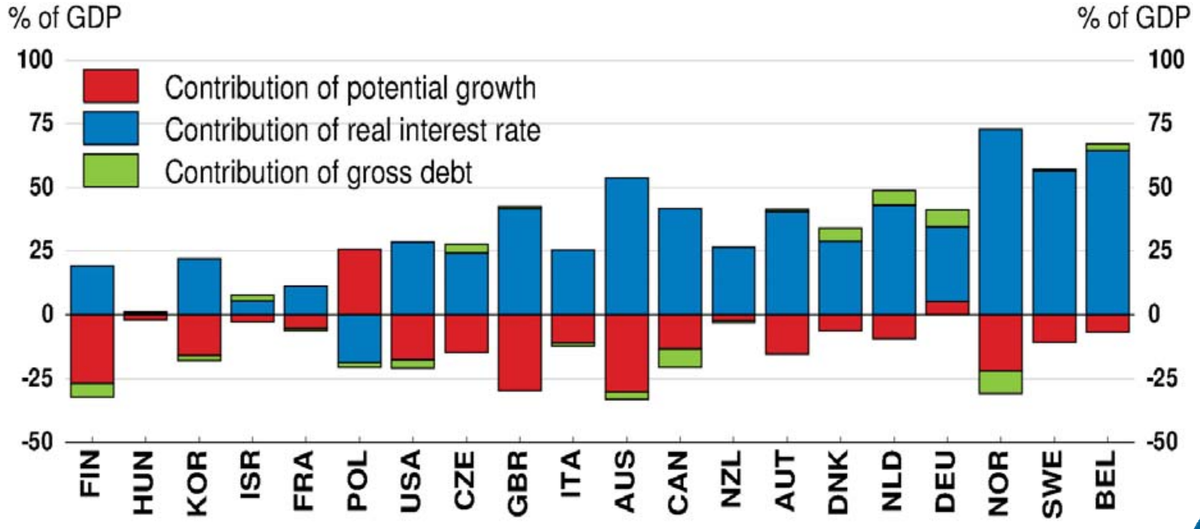
Source: OECD Economic Outlook database and OECD analytical database.

What are the main drivers of fiscal space?



Fiscal space has increased

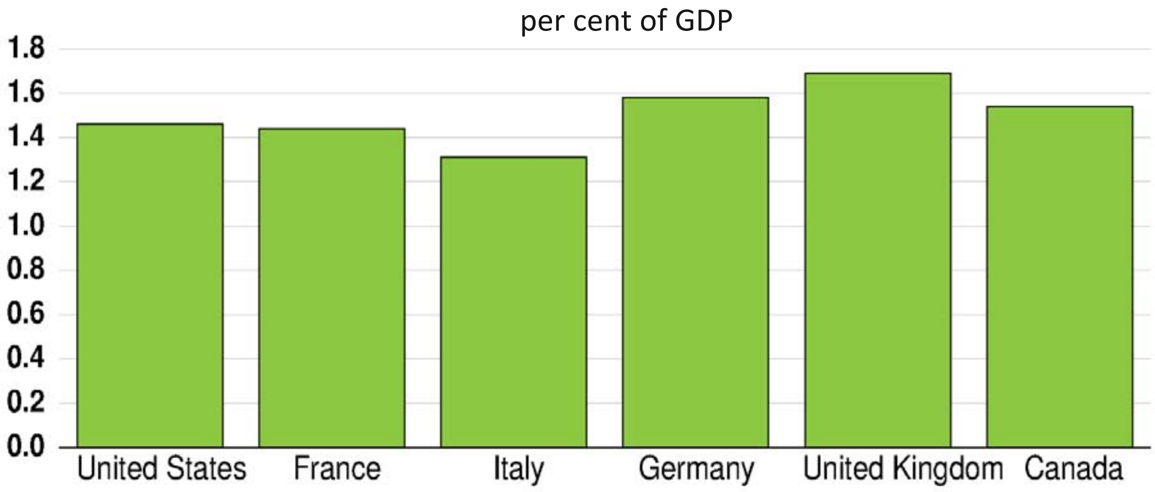
Contributions to changes in fiscal space between 2014 and 2016



Source: OECD calculations based on Fournier and Fall (2015) and OECD Economic Outlook database.

Long-term spending reforms can add further room

Healthcare reform enhances fiscal space



Note: Fiscal space is measured here in terms of tax gaps. These are computed by the difference between the actual and the sustainable tax rate, the latter being the tax rate that should prevail for the debt-to-GDP ratio in 2060 to be equal to the current level, for a given path of public spending. The reform is a change in entitlements, moving from a “cost-pressure”' to a “cost-contained” scenario.

Source: OECD calculations using Blanchard et al. (1990) and data from de la Maisonneuve and Oliveira Martins (2015).

Characterizing fiscal initiatives

What is a fiscal initiative?

Using fiscal space: Types of fiscal initiative

- Increase soft or hard infrastructure
- Increase spending on education/ childcare; do healthcare reforms
- Lower harmful taxes

Even if a country remains budget neutral

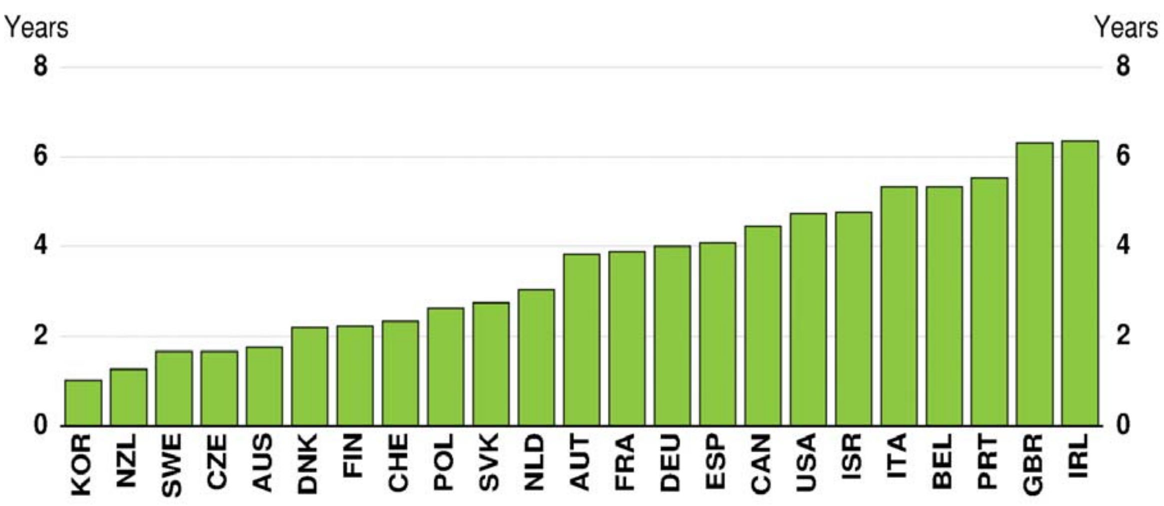
- Change the tax and spending mix to make it more supportive to growth and inclusiveness

Scenarios: ½ percent of GDP fiscal initiative

- Individually, or as collective action
- With structural reforms, and to avoid long-term unemployment

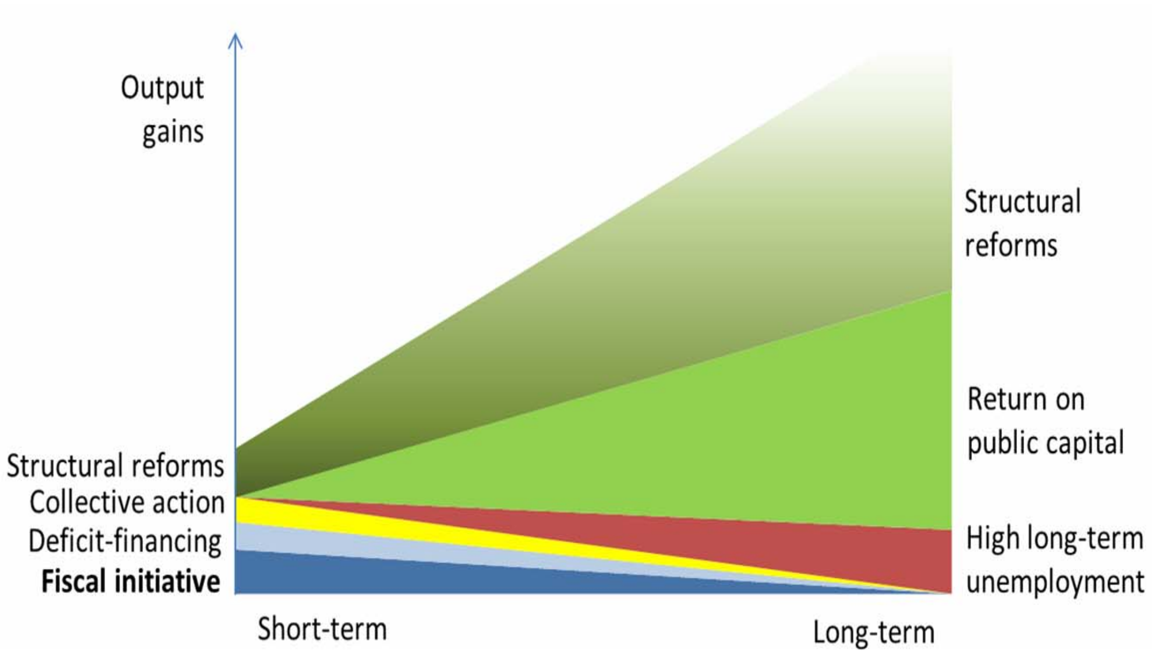
Multi-year scope for fiscal initiative

Number of years during which a fiscal initiative can be financed through temporary deficits



Note: For this graph it is assumed the fiscal initiative consist in an 0.5% of GDP increase in public investment.
Source: OECD calculations based on Mourougane et al (2016).

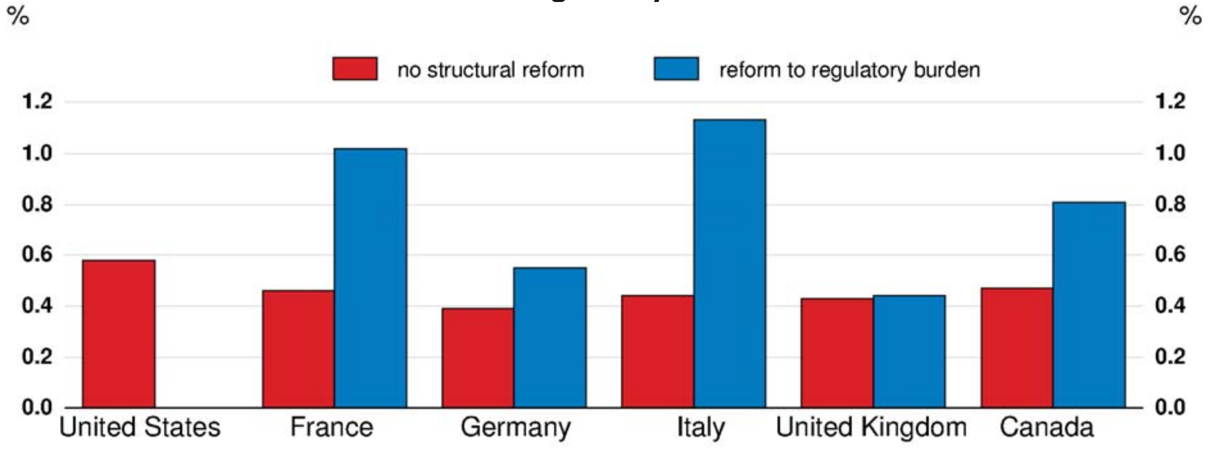
Conditions to get the most of the fiscal initiative



Note: The output gains of each effect are drawn to scale based on average country effect. The size of the effect of structural reforms, especially in the long-term, is subject to the most uncertainties and depends on the composition of the structural reform package, its timing, country-specifics, etc.

Structural reforms enhance the output gains from fiscal initiative

Output gains of the fiscal initiative with and without a 10% reduction in the regulatory burden



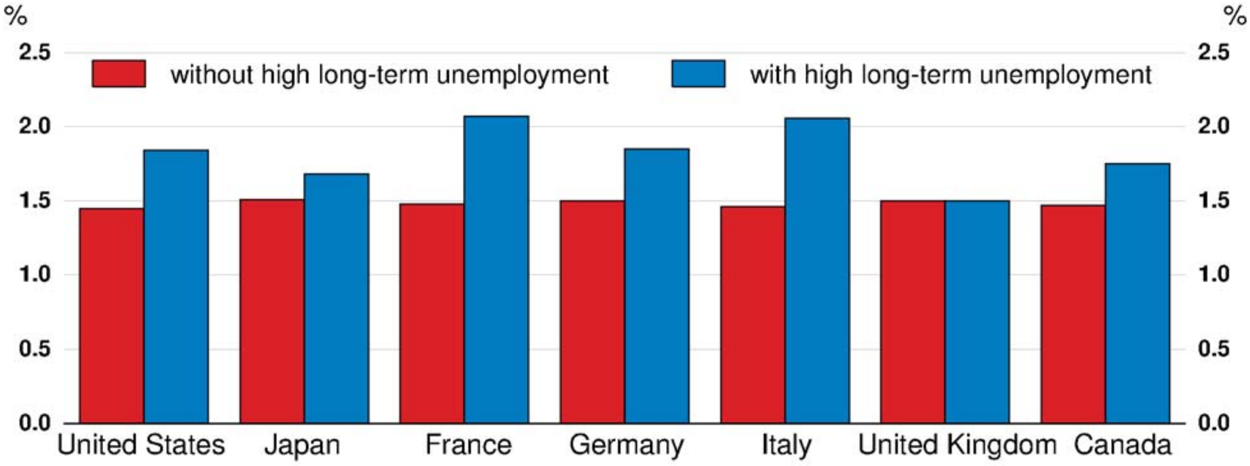
Note: The structural reform scenario is a 10% reduction in the regulatory burden stemming from anti-competitive product-market regulation in upstream sectors (electricity, gas, telecom, post and air, rail and road transports, retail distribution and professional services) as measured by the OECD indicators (Egert and Wanner, 2016). Its effect on total factor productivity has been derived from Bourlès et al. (2010), where total factor productivity depends on institutions and the distance to the frontier country (the United States).

Source: OECD calculations using the FM model.

High long-term unemployment reinforces the case for a fiscal initiative

Long-term output gains in the case of a 0.5% of GDP increase in public investment

difference to baseline

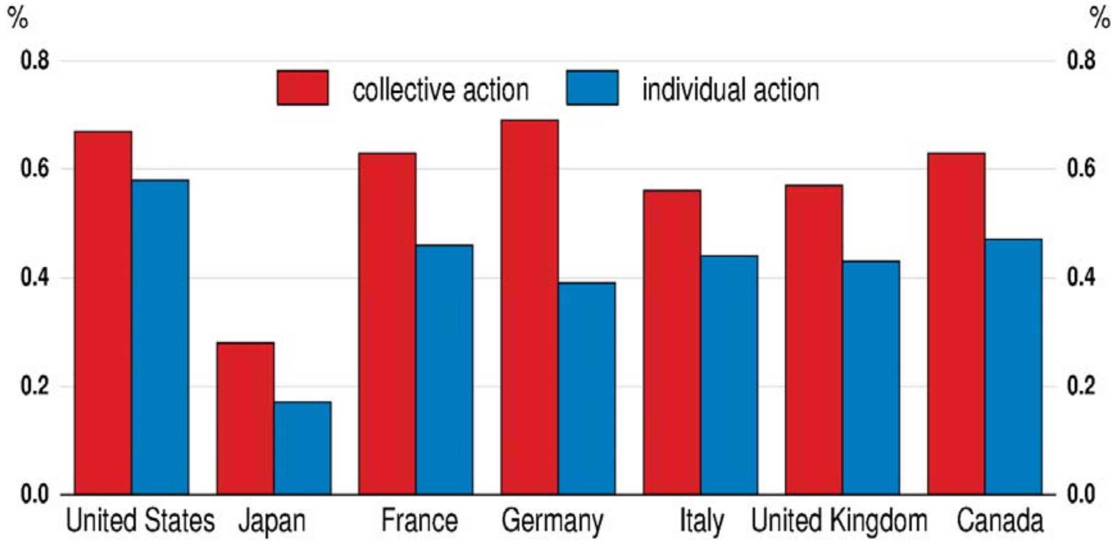


Source: OECD calculations using the FM model.

Collective action raises short-term output gains

Output gains of a 0.5% of GDP fiscal initiative,

difference to baseline after one year



Note: collective action means simultaneous fiscal initiative in all G7 countries.

Source: OECD calculations using the FM model.

Impact of different instruments on growth and equity

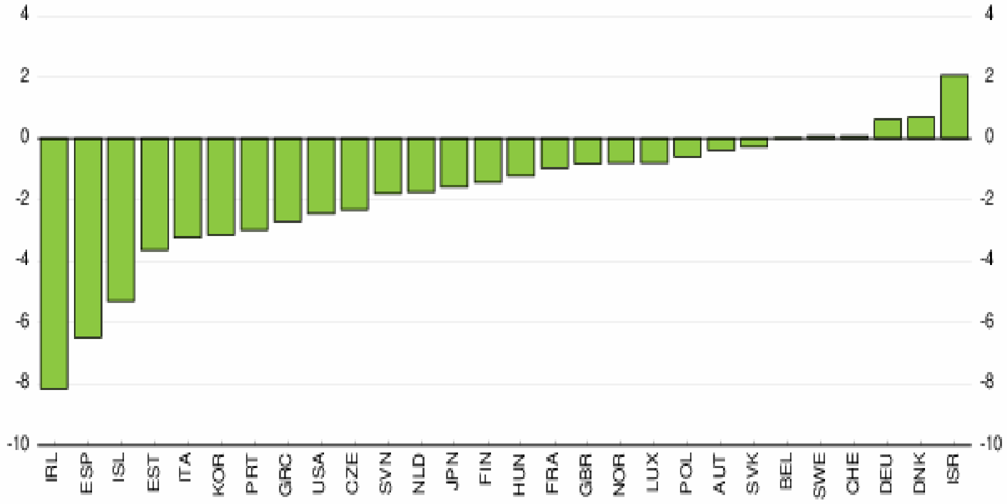
Policy	Growth	Income of the poor	Countries with the most room for growth gains
Reforms increasing government effectiveness	+	+	FRA, GRC, HUN, ITA, SVN
Reforms increasing education outcomes	+	+	CHL, GRC, MEX, PRT, TUR
Increasing public investment (including R&D)	+	+	BEL, DEU, GBR, IRL, ISR, ITA, MEX, TUR
Reducing pension spending	+	+	AUT, DEU, FIN, FRA, GRC, ITA, JPN, POL, PRT, SVN
Increasing family benefits	0	+	CHE, ESP, GRC, PRT
Decreasing public subsidies	+	0	BEL, CHE

Note: + stands for a positively significant and 0 for non-significant effect. The countries with most room for growth gains are those where reforms would yield gains of more than 10% of GDP. For family benefits, the table shows countries where the reform would increase the income of the poor by more than 20%.
The effect on the poor is the effect on a synthetic income indicator that gives the largest weight to the lowest income decile. The analysis is based on information up until 2013 and therefore does not reflect recently implemented reforms.

Source: Fournier and Johansson (2016), "The Effect of the Size and the Mix of Public Spending on Growth and Inequality", OECD Economics Department Working Papers, forthcoming.

Yet, the share of productive spending fell between 2007 and 2013

Change in education and public investment share,
as a percentage of cyclically-adjusted primary expenditure



Source: OECD Public Finance Dataset, forthcoming.

Many countries plan the right fiscal stance, but many could do more

Projected fiscal stance	Contractionary	Mildly contractionary	Broadly neutral	Mildly expansionary	Expansionary
Contractionary					
Mildly contractionary		ARG, BRA, COL, CRI, GRC, SVK	BEL	AUS, GBR, IDN, KOR	
Broadly neutral			CHL, CZE, DNK, ESP, IND, IRL, ISR, JPN, LTU, MEX, NZL, PRT,TUR, SWE, ZAF	AUT, FIN, NLD,FRA, RUS, TUR	CHE
Mildly expansionary	HUN		SVN	CAN, ITA, NOR, POL	DEU, EST, LVA
Expansionary	ISL			CHN	LUX, USA

OECD recommends more expansionary than planned

OECD recommends less expansionary policy than planned

Further information

Mourougane, A., J. Botev, J.-M. Fournier, N. Pain and E. Rusticelli (2016), "Can an increase in public investment sustainably lift economic growth?", *OECD Economics Department Working Papers*, No. 1351, OECD Publishing, Paris.

Botev, J., J.-M. Fournier and A. Mourougane (2016), "A reassessment of fiscal space in OECD countries", *OECD Economics Department Working Papers*, No. 1352, OECD Publishing, Paris.

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