DG ECFIN Webinar:
The role of fiscal policy in mitigating the COVID-19 crisis

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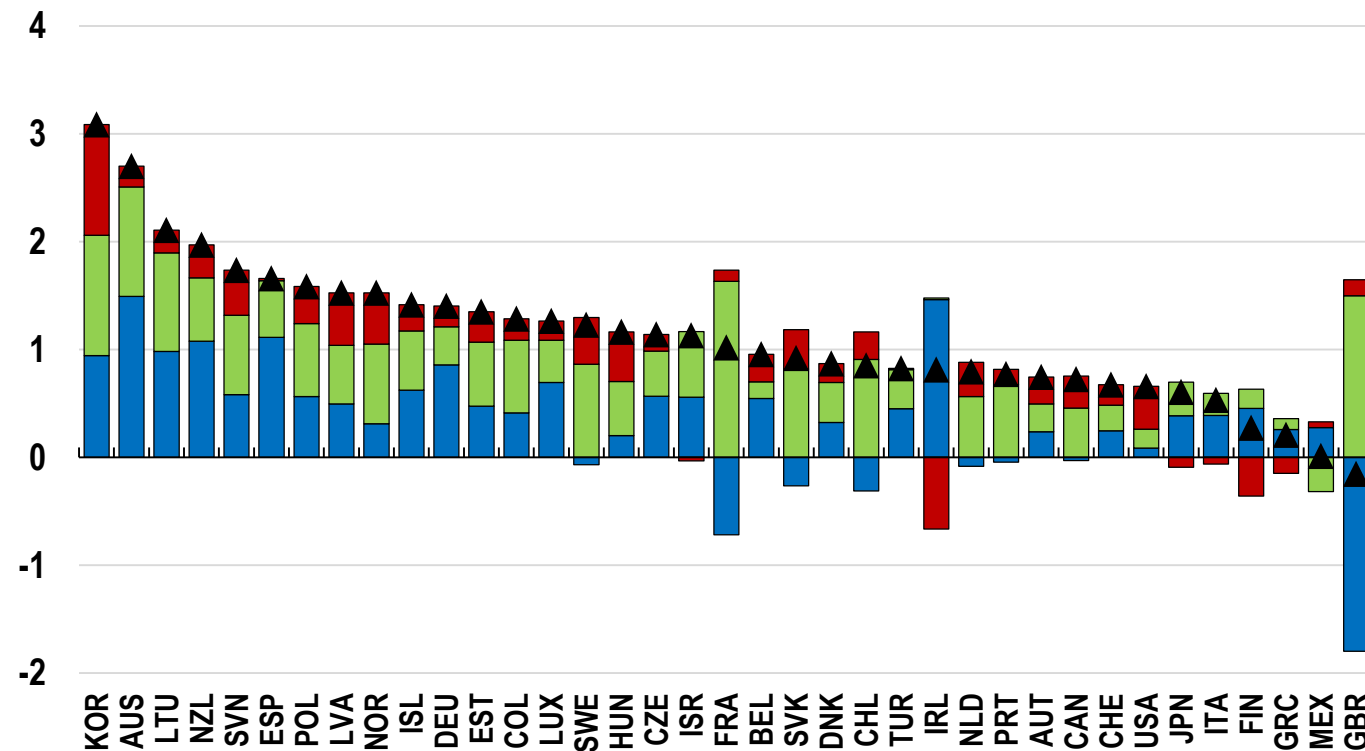**OECD Chief Economist**

Fiscal policy is providing a considerable support to growth

Projected contribution of real government consumption to real GDP growth
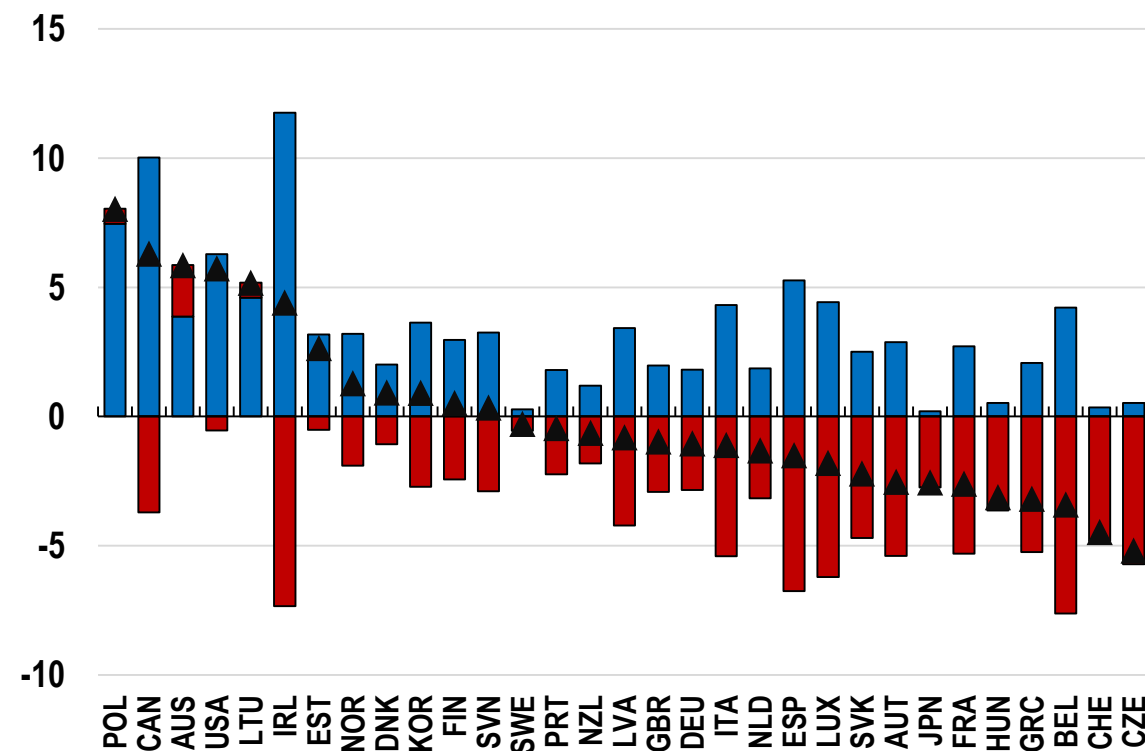*% points*

■ 2020 ■ 2021 ■ 2022 ▲ Total

Projected contributions to household disposable income growth in 2020
% points

■ Social transfers ■ Market income ▲ Total

Note: Comparisons of the impact of government consumption across countries during the pandemic are affected by national differences in the statistical measurement of real public sector expenditure and output, particularly in education and health. Countries using specific output volume measures rather than measures based on deflated nominal inputs, such as the United Kingdom, recorded declines in real government consumption during the lockdown despite higher nominal government spending.
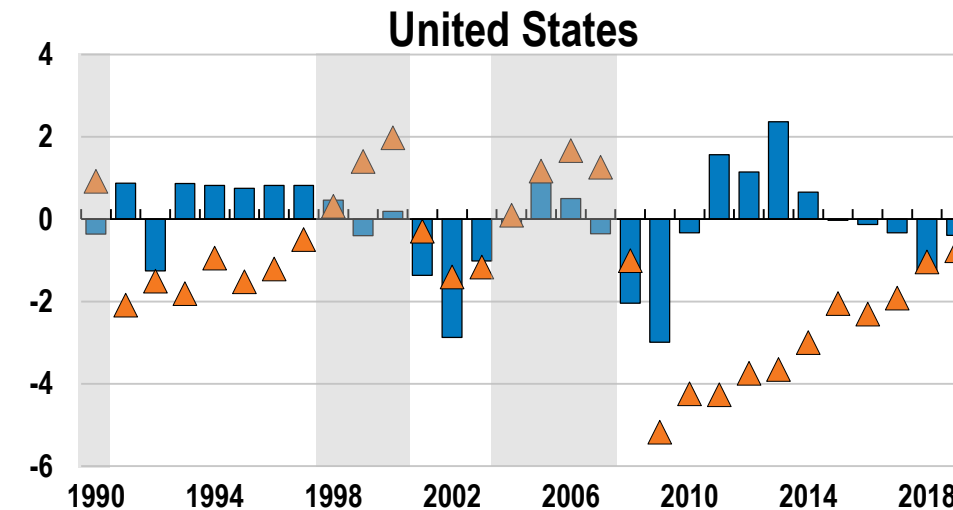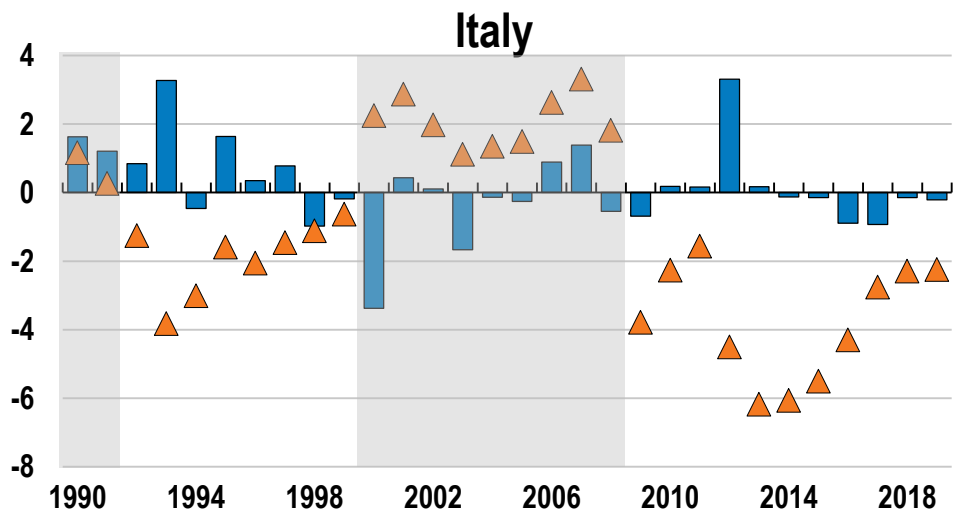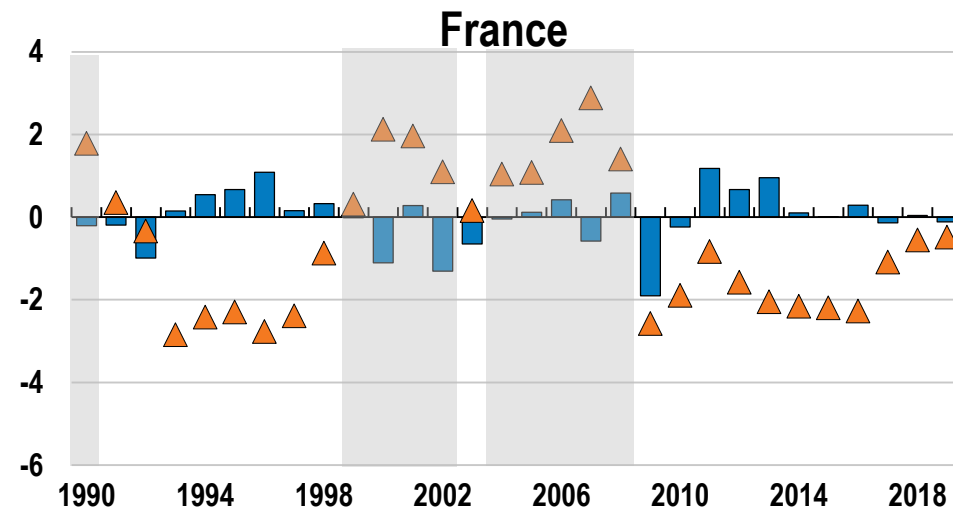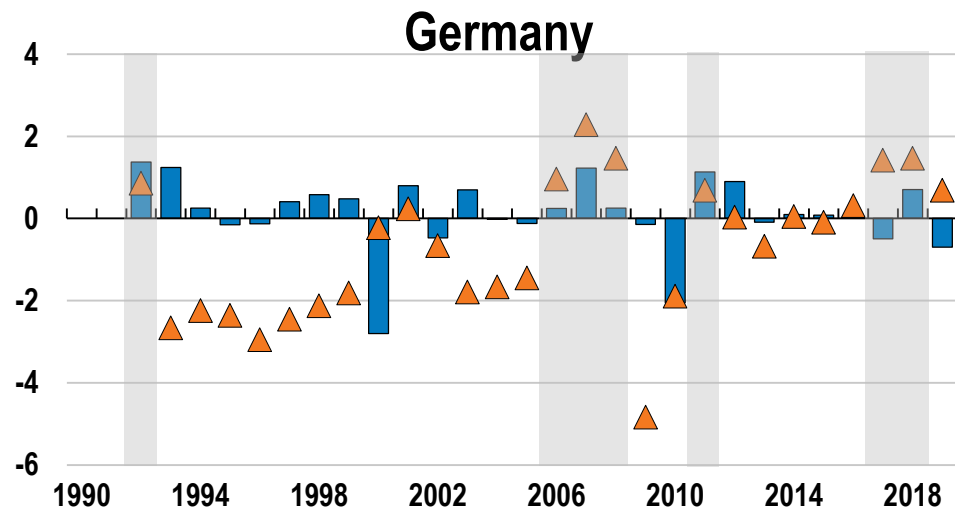Source: OECD Economic Outlook 108 database; and OECD calculations.

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About the use of fiscal tool

Policy is not clearly counter-cyclical during upturns
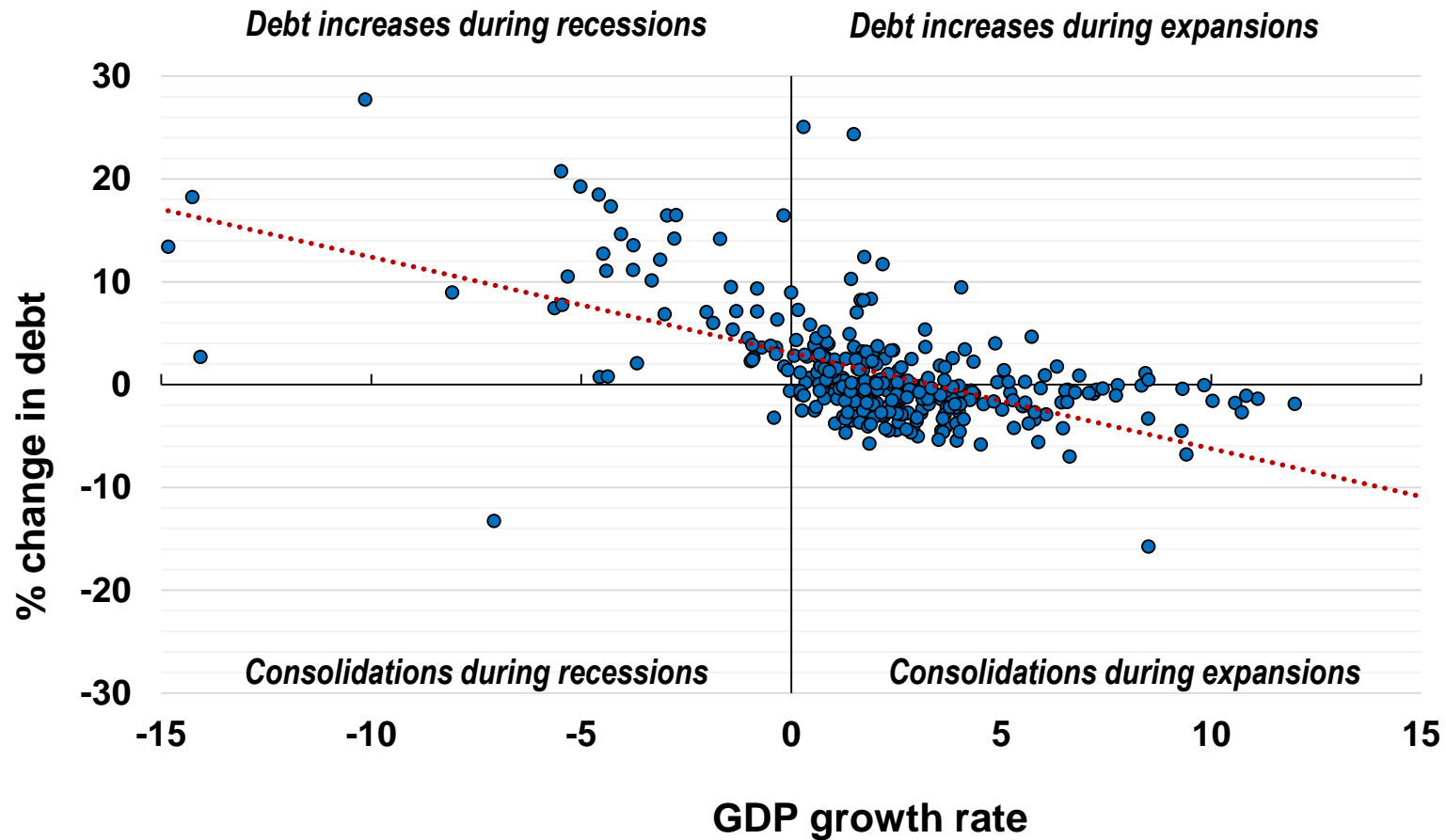

Germany

France

Italy

United States

Annual change in the underlying primary balance (% points)

Output gap (% of potential output)

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Debt increases mostly during expansions

Debt changes and growth
Euro area countries, 2000-2019

Note: y = -0.9322x + 3.0931 R² = 0.3742. The sample includes euro area countries also members of the OECD (17 countries).
Source: OECD calculations.
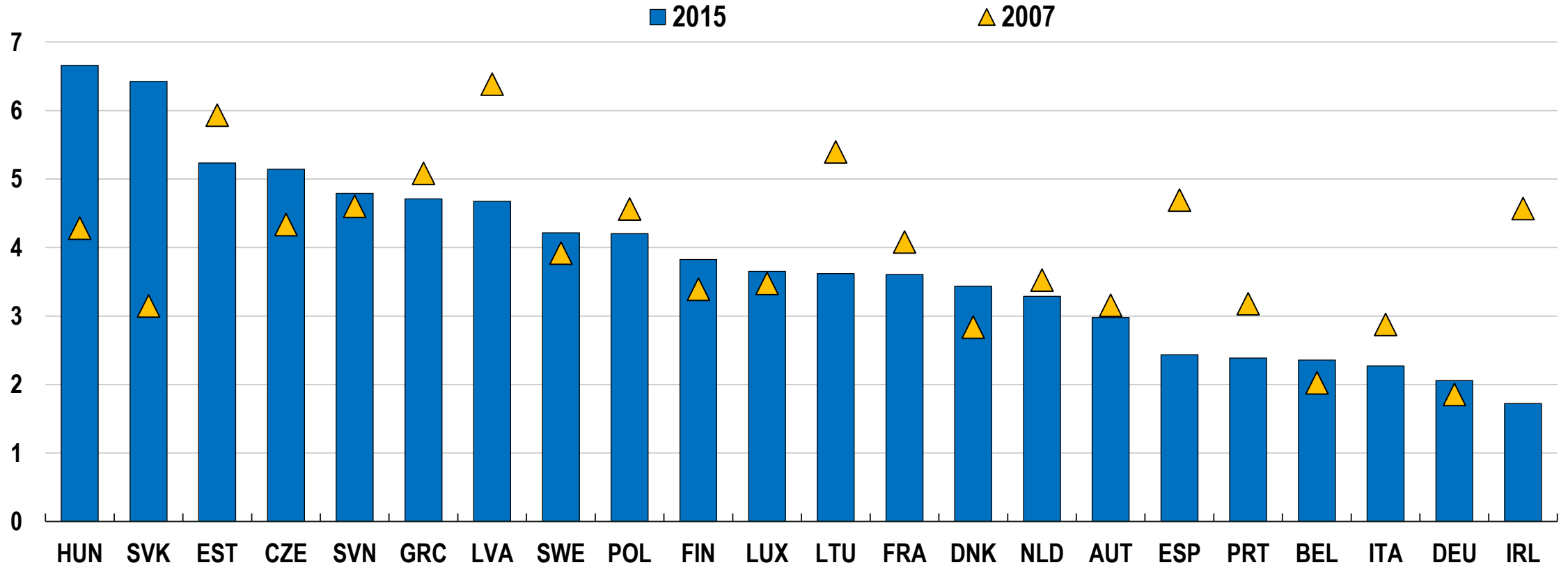
Investment has tended to decrease

Governments typically cut investment when they consolidate
Government investment, % of GDP

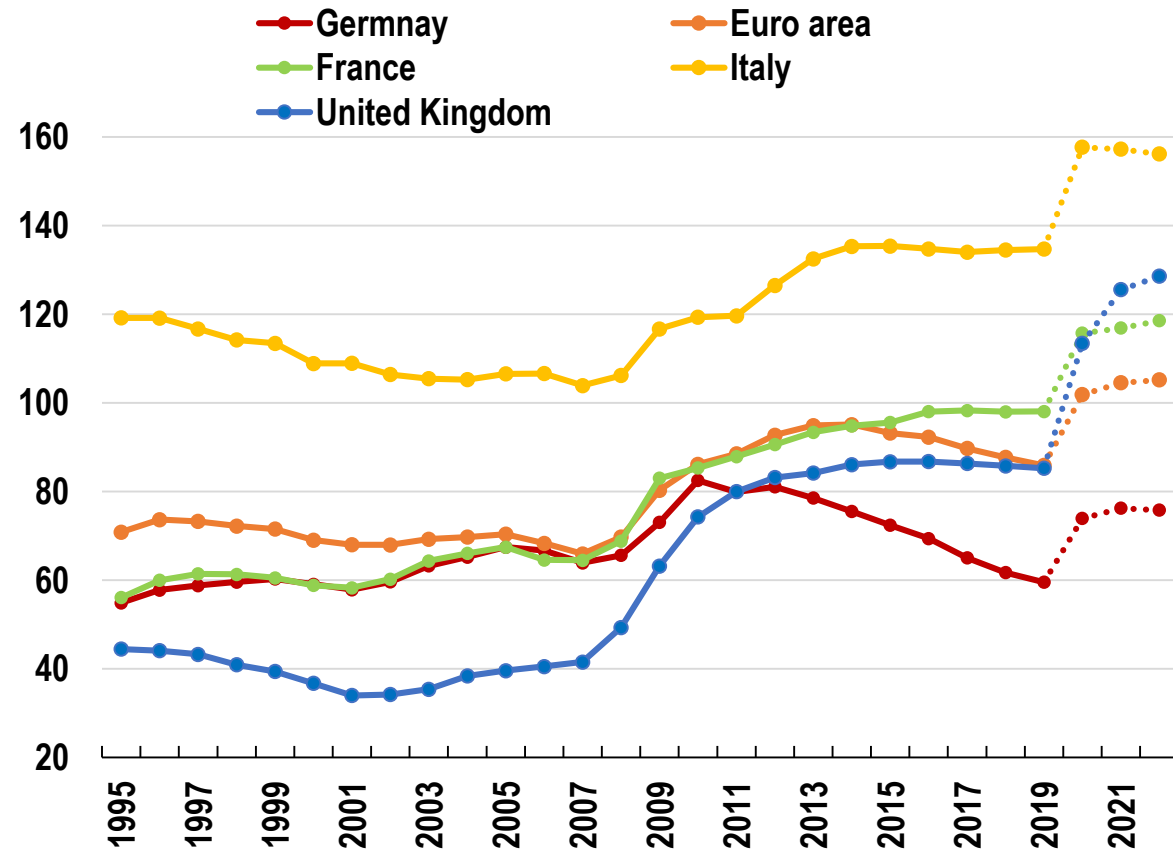Legend: ■ 2015   ▲ 2007

Source: OECD National Accounts Statistics (database).

Debt levels have been steadily increasing

Global public debt
% of GDP
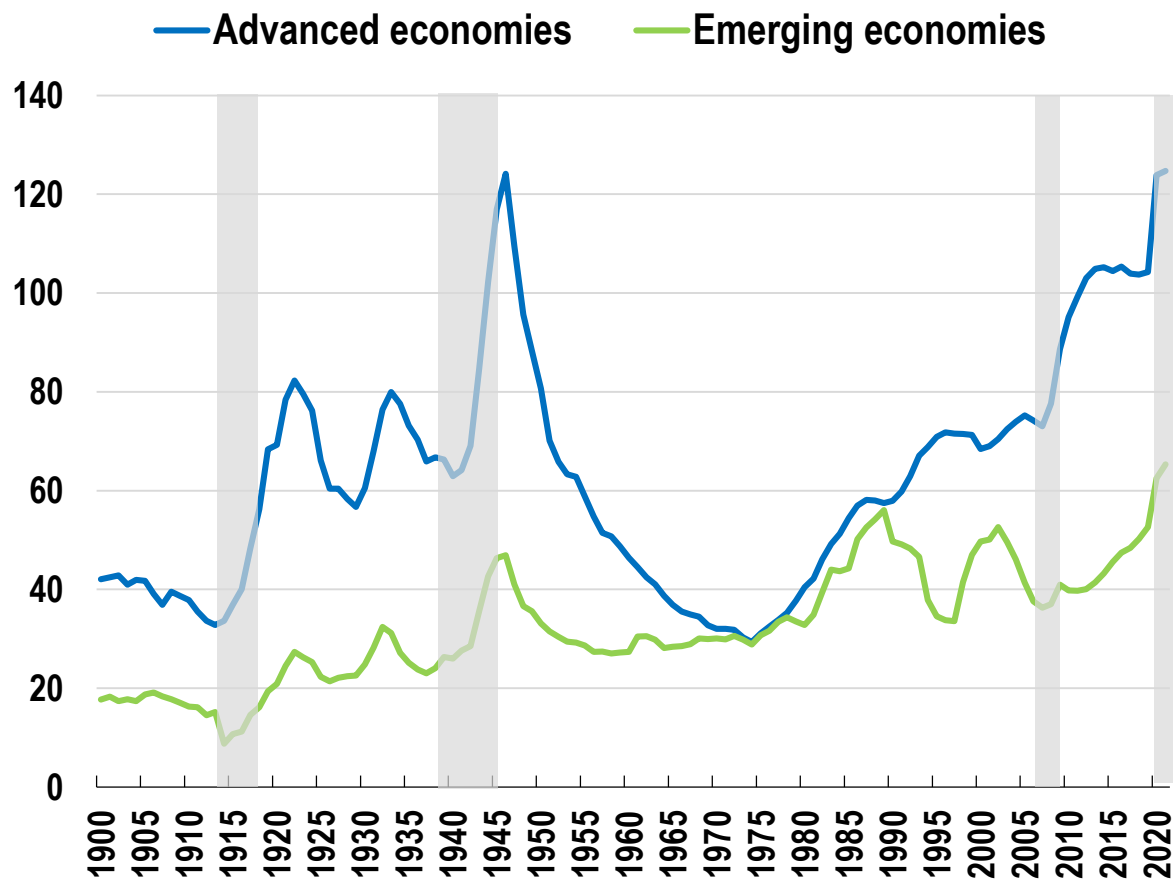
General government debt
% of GDP, Maastricht definition

Note: LHS: The aggregate public-debt-to-GDP series for advanced economies and emerging market economies is based on a constant sample of 25 and 27 countries, respectively, weighted by GDP in purchasing power parity terms. Advanced and emerging economies follow the IMF's country classification. RHS: Dotted lines correspond to the OECD Economic Outlook 108 projections.
Source: IMF October 2020 Fiscal Monitor "Policies for the Recovery" using IMF, historical public debt database; IMF, World Economic Outlook Database; Maddison Database Project; and IMF calculations; OECD Economic Outlook 108 database; and OECD calculations.
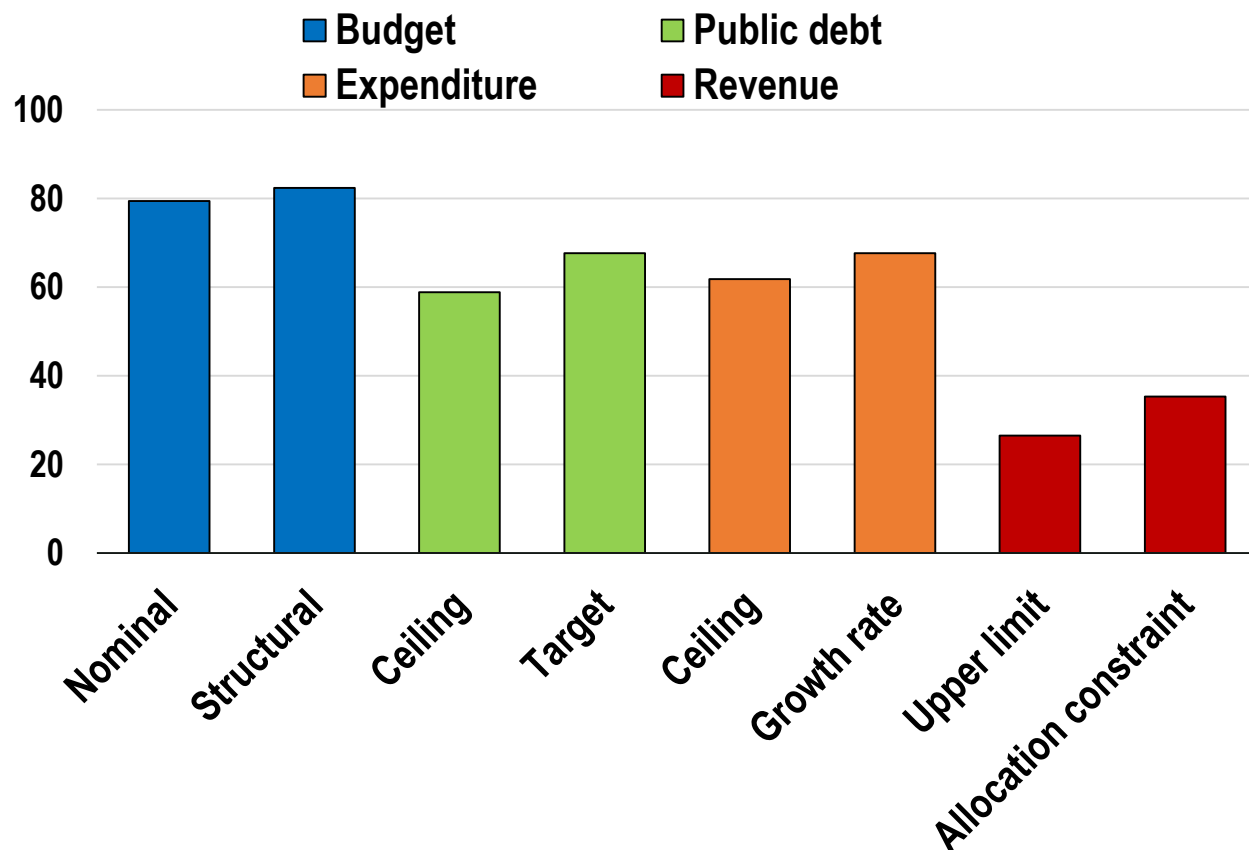
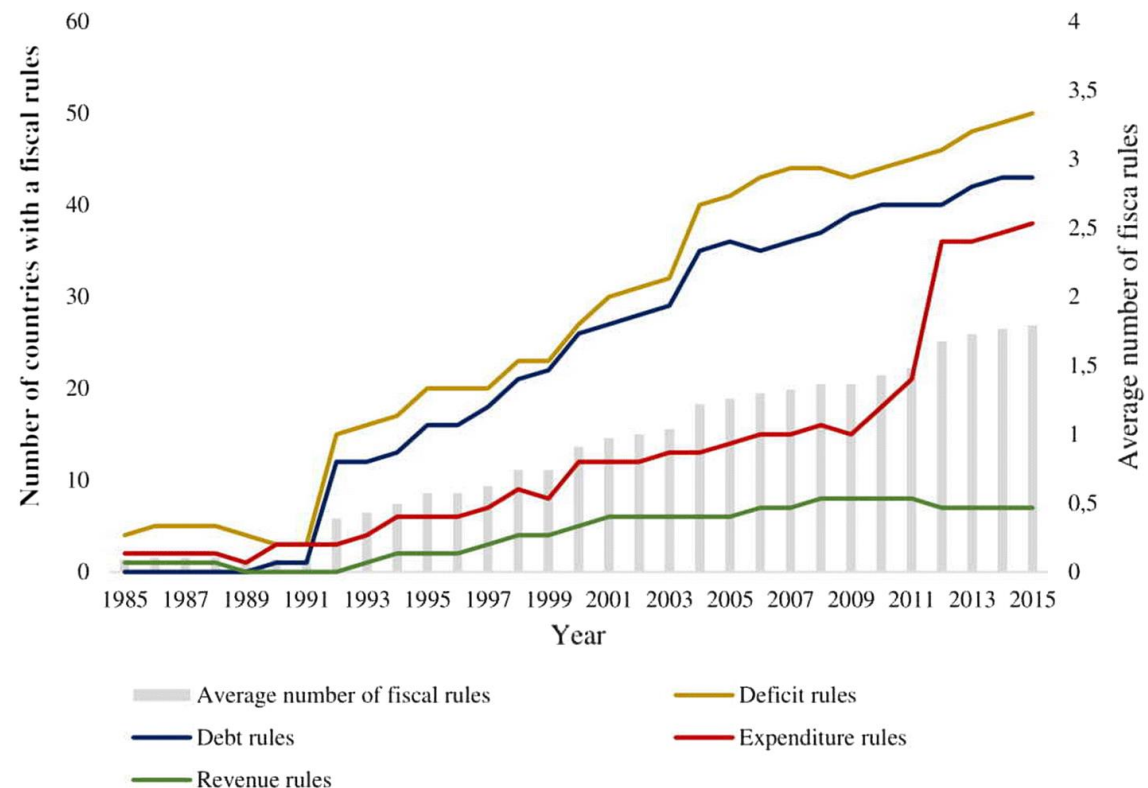# *Deficit, rules and political economy*

There is no lack of fiscal rules

The balanced budget rule is the most commonly used

% of OECD countries using fiscal rules, out of a sample of 34 countries

Type of fiscal rules in place in a sample of 77 countries

Note: LHS: Data for the US are not available.
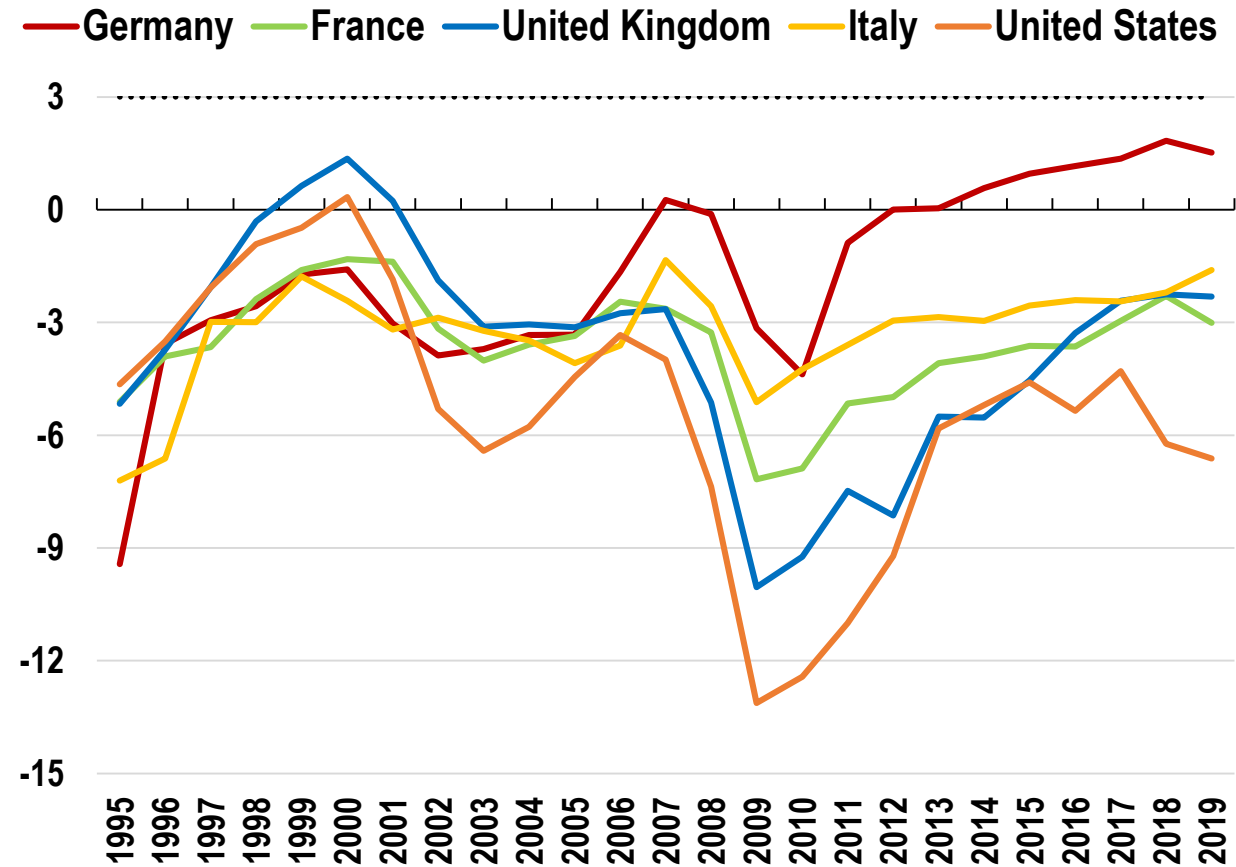Source: OECD (2018), OECD Budget Practices and Procedures Survey, Question 11, OECD, Paris; IMF fiscal rules dataset; Gootjes et al. (2020), Do fiscal rules constrain political budget cycles?.

Budget deficits have been persistent

Percent years of general government deficit over 1995-2019
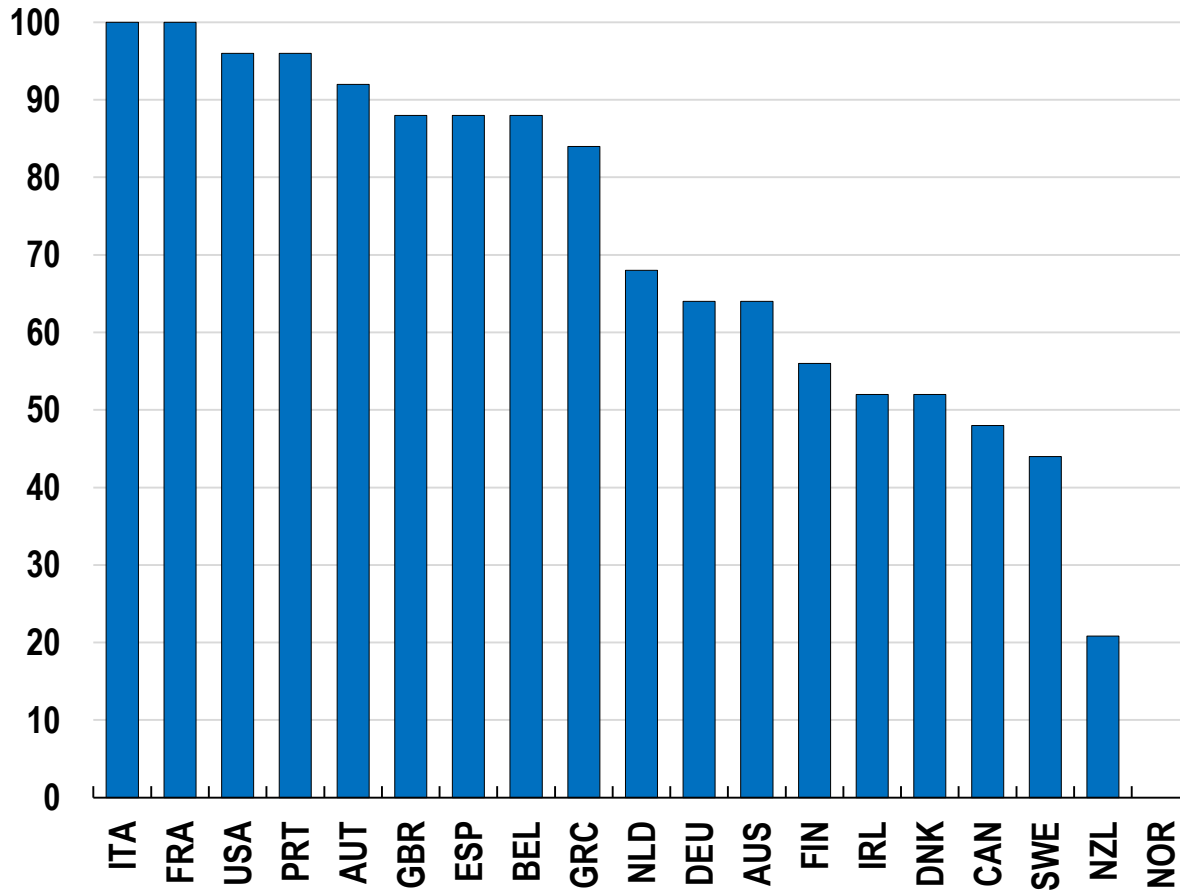
General government budget balance
% of GDP

Legend: Germany, France, United Kingdom, Italy, United States

Note: LHS: Percent years of deficit over 1996 and 2019, except for New Zealand which covers the period 1995-2018. Japan excluded due to lack of data available pre-2005.
Source: OECD National Accounts database.
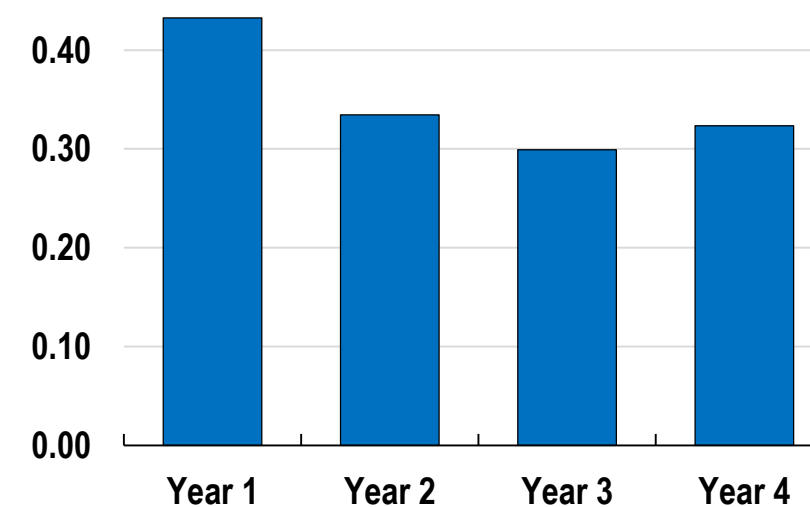
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Political economy reasons for deficit bias

- **Electoral cycles**: tend to push for spending before elections and austerity after –depending on political swings

- Fragmentation of the political landscape, voters or parties, contributes to increase the **common-pool** issue

- **Fiscal illusion**: voters do not fully internalise the long-term or intra-generational costs of their preferences

The growth rate of public investment peaks 21-25 months pre-elections
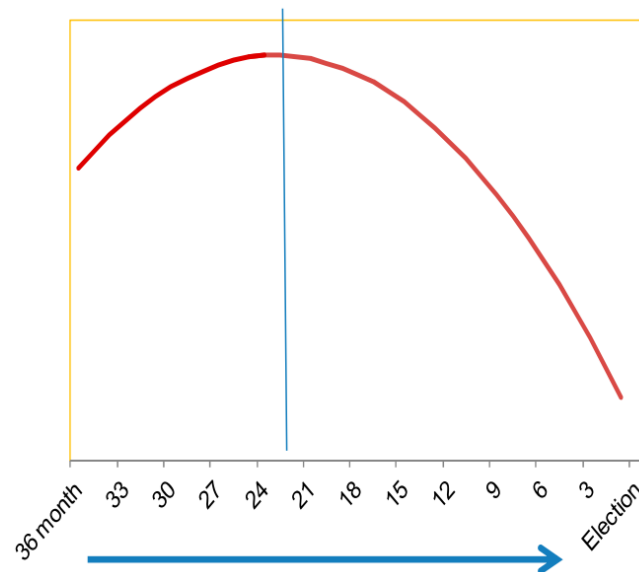
Austerity is larger in the first year of the electoral term
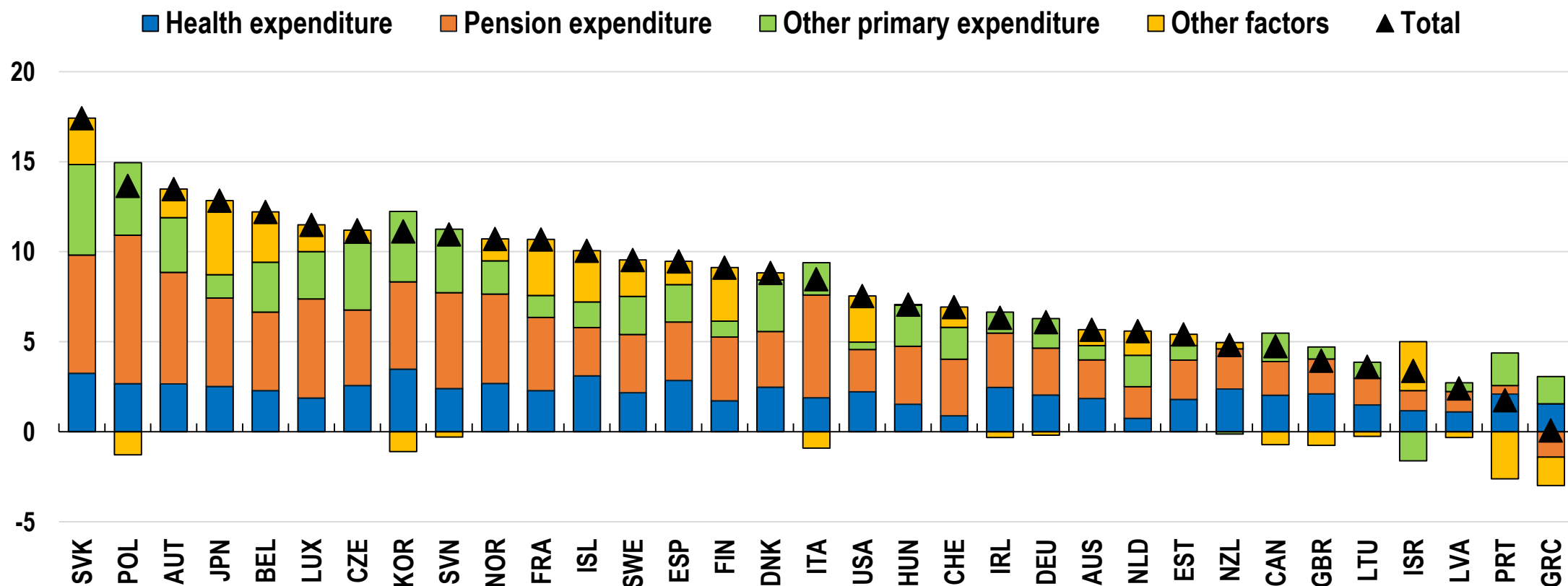*% of GDP, average over all consolidation announcements*

Are we equipped for future shocks?
Three factors to take into account

Upward pressures on public finances lie ahead

Potential future tax pressure to keep the public debt ratio at current level under unchanged policies

Change in structural primary revenue between 2021 and 2060, % points of potential GDP

■ **Health expenditure**　　■ **Pension expenditure**　　■ **Other primary expenditure**　　■ **Other factors**　　▲ **Total**

Note: The chart shows how the ratio of structural primary revenue to GDP must evolve between 2021 and 2060 to keep the gross debt-to-GDP ratio stable near its current value over the projection period (which also implies a stable net debt-to-GDP ratio given the assumption that government financial assets remain stable as a share of GDP). The underlying projected growth rates, interest rates, etc., are from the baseline long-term scenario. Expenditure on temporary support programmes related to the COVID-19 pandemic is assumed to taper off quickly. The necessary change in structural primary revenue is decomposed into specific spending categories and 'other factors'. This latter component captures anything that affects debt dynamics other than the explicit expenditure components (it mostly reflects the correction of any disequilibrium between the initial primary balance and the one that would stabilise the debt ratio).
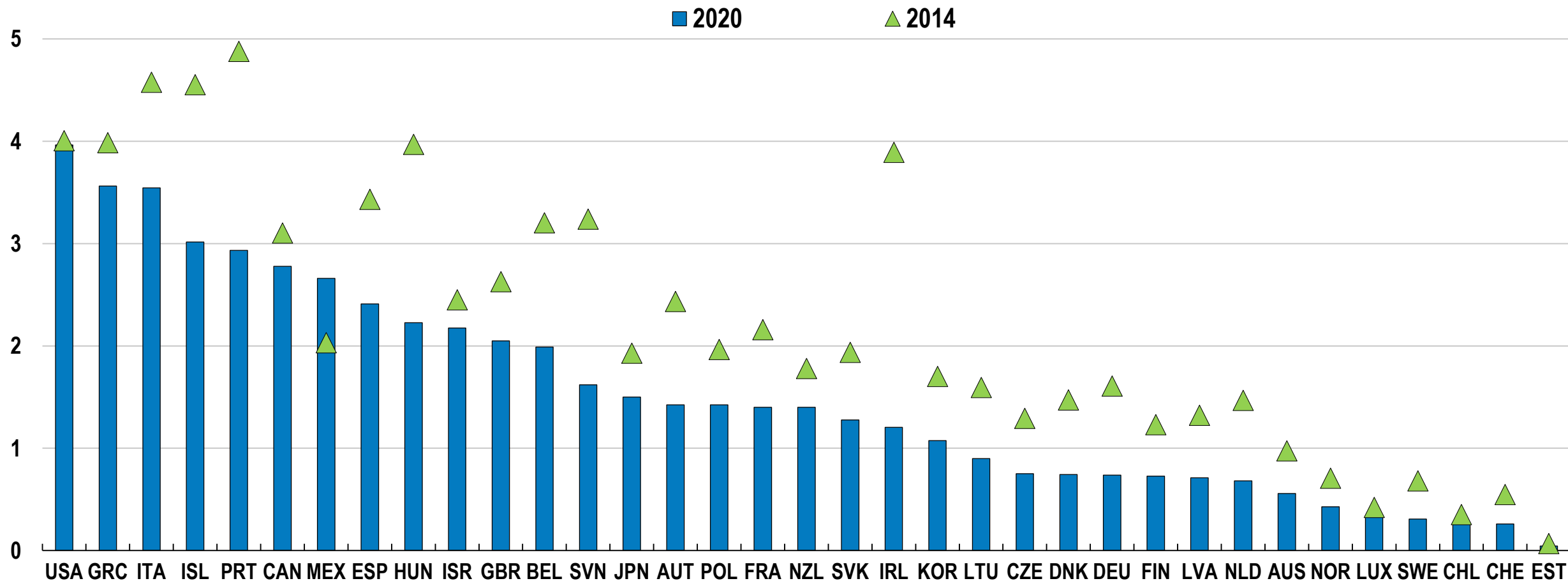Source: OECD (forthcoming) The long game: fiscal outlooks to 2060 underline need for structural reform.

OCDE

Monetary policy is buying time to address these biases

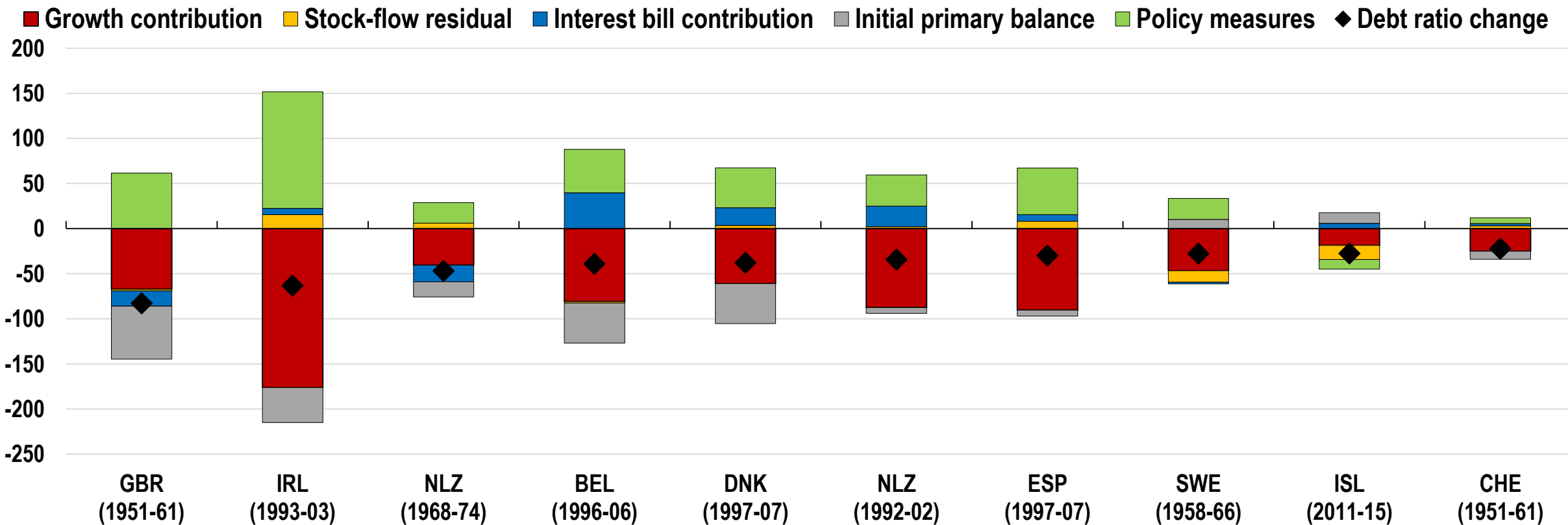## The cost of debt service has fallen
Government debt servicing payments, % of nominal GDP

■ 2020   ▲ 2014

Note: Value of gross government interest payments as a share of nominal GDP.
Source: OECD Economic Outlook 108 database; and OECD calculations.

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Economic growth is an important factor in reducing the debt ratio

Sources of largest decreases in debt-to-GDP ratios since 1950
% points

Legend: ■ Growth contribution ■ Stock-flow residual ■ Interest bill contribution ■ Initial primary balance ■ Policy measures ◆ Debt ratio change

Categories: GBR (1951-61), IRL (1993-03), NLZ (1968-74), BEL (1996-06), DNK (1997-07), NLZ (1992-02), ESP (1997-07), SWE (1958-66), ISL (2011-15), CHE (1951-61)

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Directions for a more sustainable fiscal framework

Objectives in reviewing the fiscal framework

☑ Establish stronger **links between current budget, growth and long-term sustainability**
- **Smooth economic cycles** (AS, infrastructure investment as a counter-cyclical policy)
- Provide **buffer** against shocks
- Have regard to **efficiency and equity**
- Foster **long-term GDP growth**

☑ **Ensure political commitment and transparency**
- Fiscal **credibility** comes from **political reputation** and the way public finances are managed
- **Independent institutions** to :
  - underpin **macro-economic projections** feeding into the budget
  - **evaluate policies impact** on long-term public finances sustainability
  - **assist parliament** with the assessment of the impact of policies and budget decisions on long-term sustainability

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Strengthen the scope and the degree of independence of independent fiscal institutions

Comparison of independent fiscal institutions roles and functions
Staffing levels, 2017 or latest available

Source: OECD Independent Fiscal Institutions Database (2017).
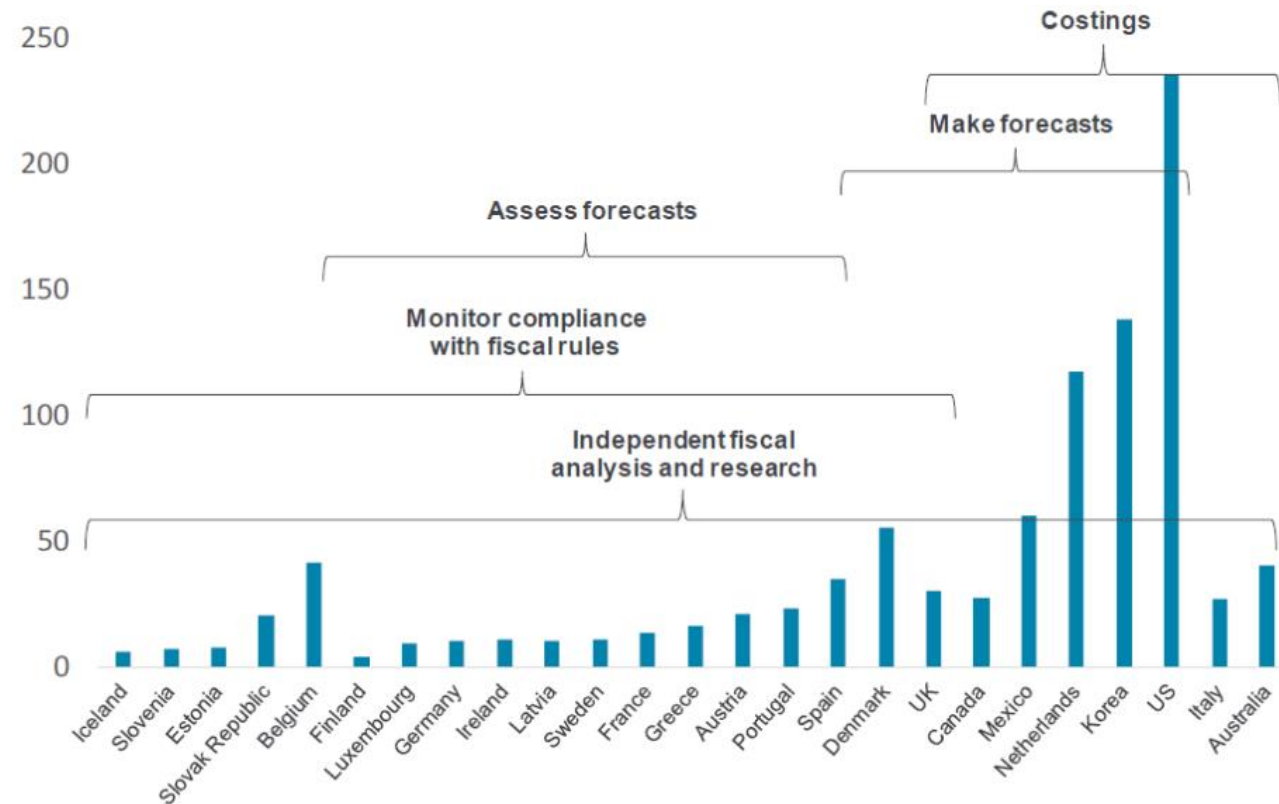
International experience examples

Netherlands

- CPB **independent forecaster for the budgetary process**
- Produces: macro forecasts, midterm review of PF at the start of each election cycle, and cost benefit analysis of policy proposals.
- **Assesses each party's manifesto on budget & debt sustainability, structural employment and income inequality**

Canada

- PBO assists parliamentary oversight of the budget
- **Costs individual policy proposals as well as overall cost assessments of federal gvt budget**

Sweden

- Framework based on **trust and support from the population**
- **Country-specific debt anchor** helped reduce debt but could prove challenging to change
- Boosted **financial markets' confidence**

New Zealand

- Treasury is **independent forecaster for the budgetary process**
- Framework based on **transparency** (e.g., emphasises disclosure of info. over compliance) and **political commitment to a fiscal path**
- **Flexibility** and frequent performance assessment

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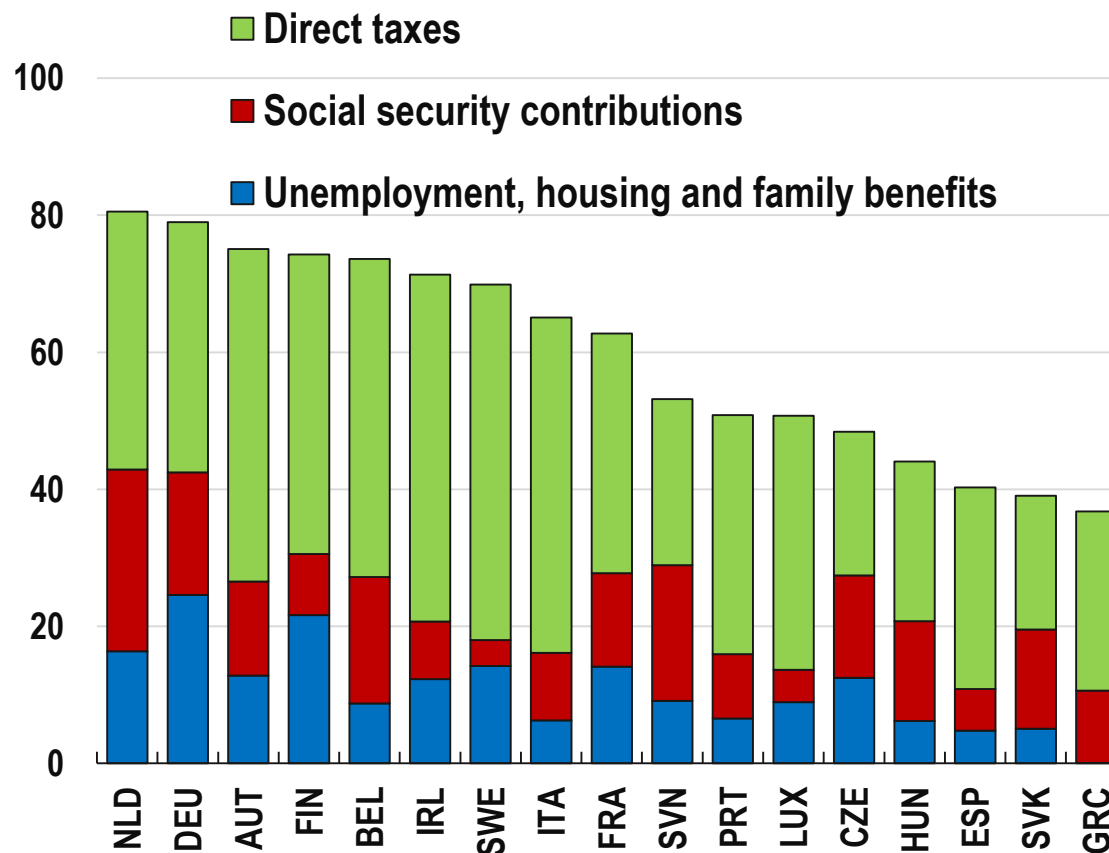# Rules in a semi-autonomous framework in the EU

European-level

- European framework should **set broad principles**
- **European institutions** should set principles for and monitor scope and independence of IFIs
- **Europe should pursue SURE** for strengthening automatic stabilisers

National-level

- **Specific rules and numerical targets** should be set at the national level, as well as **the speed of compliance** with targets
- **Action, scope and independence of IFIs** to be reviewed and expanded where needed
- **Investment preparedness** to help counter-cyclical action

Strength of automatic stabilisers
% of income shock offset by automatic stabilisers

Legend:
- Direct taxes
- Social security contributions
- Unemployment, housing and family benefits

Countries (left to right): NLD, DEU, AUT, FIN, BEL, IRL, SWE, ITA, FRA, SVN, PRT, LUX, CZE, HUN, ESP, SVK, GRC

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Thank you

Find out more about our work at:

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🐦 https://twitter.com/oecdeconomy

✉ eco.contact@oecd.org

📰 https://oecdecoscope.blog/