Fiscal Policy and Structural Reforms

Vitor Gaspar
Director, Fiscal Affairs Department
International Monetary Fund

Bruegel Workshop
“Structural reforms: Dynamic growth impact and policy challenges”
November 2, 2015
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

United States

Global financial crisis

Great depression

Euro Area

Japan

Note: For the Euro Area, the 1929 to 1936 series corresponds to the average across France, Germany, and Italy.
1. Risks in the Macroeconomic Landscape
Low growth expectations, low inflation for too long

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

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

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

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
• 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)
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!