



How Can Economic Policies Work Together to Support Durable Growth?

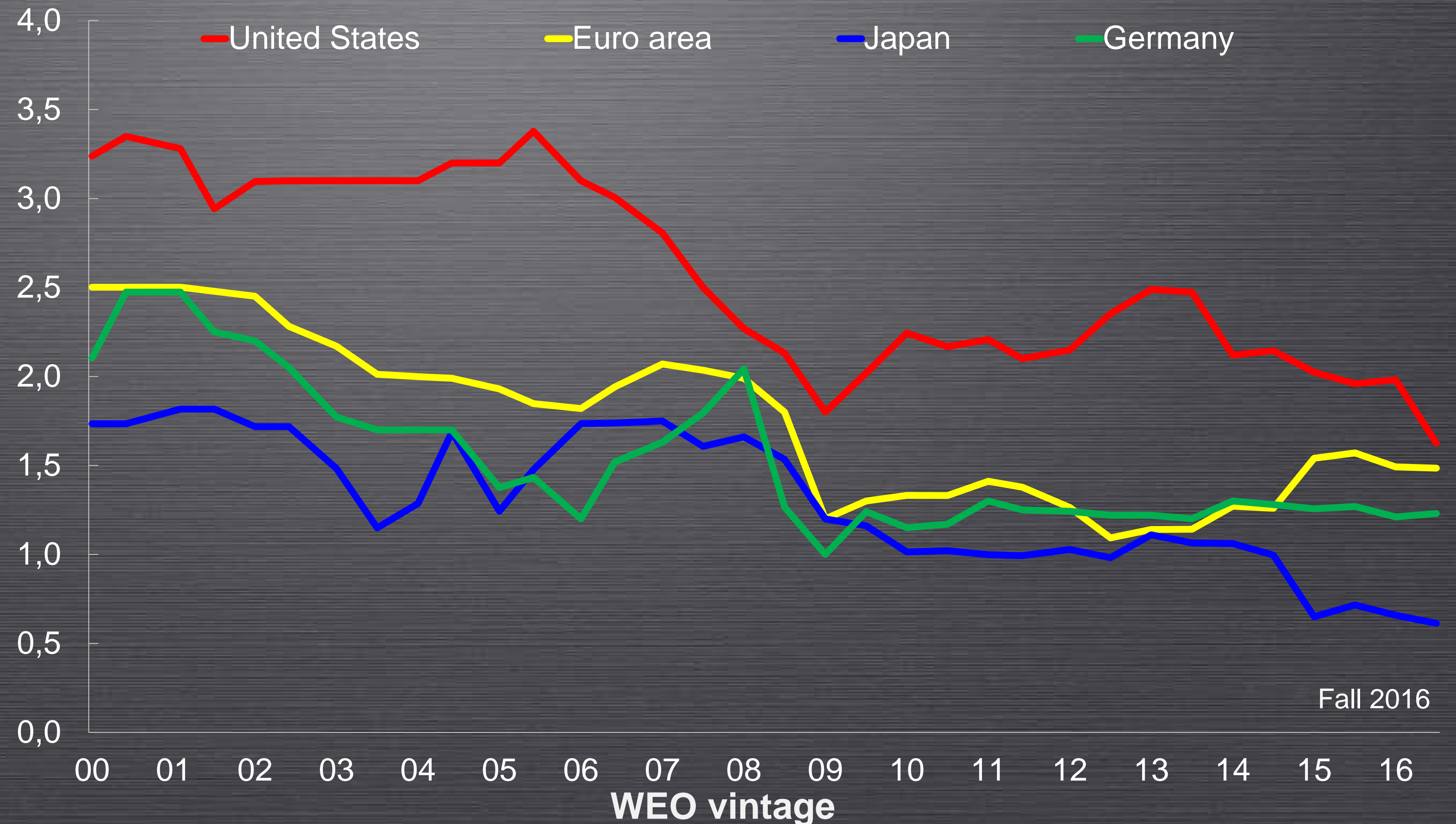
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Potential real economic growth has fallen this century

Successive medium-term WEO growth forecasts have declined, suggesting that potential GDP growth rates in the advanced economies have been falling over time (also true for many EMs, notably China)

(Percent per year; WEO vintages; t+5 forecast)



Source: IMF, *World Economic Outlook*

The IMF research agenda has evolved accordingly

- This paper
- IMF *World Economic Outlook*, ch. 3, April 2016
- Forthcoming (April) Staff Discussion Note on potential growth trends, headwinds, and legacies
- And much, much more ...

A lot of this work focuses on structural issues

- But for the past few years we have recommended a “three-pronged approach”—tailored to country situations (e.g., fiscal space), but potentially comprising
 - Monetary
 - Fiscal
 - Structural (can include—though not in this paper—financial-sector policies, such as balance-sheet repair infrastructure)
- Why? Policies can be *complementary*
 - Monetary may need fiscal to help fight deflation at ZLB
 - Financial reform (cleaning NPLs) unclogs transmission
 - Structural reforms can affect *Debt/GDP* ratios
 - Fiscal can affect prospects for structural reform implementation

Today's paper focuses on structural-fiscal synergies

- Some structural reforms lower *Debt/GDP* ratios over the medium term—why does this matter?
 - Can generate space for supportive fiscal policy
 - Or: can promote resilience—as most euro area countries need to reduce debt over the medium term
 - Where fiscal space is lacking, budget neutral but growth-friendly packages (e.g., shift spending toward productive infrastructure)
 - Credible fiscal framework, reform ownership stabilize expectations, and are especially essential when fiscal space is very low
- Some structural policies contractionary under slack
 - Require fiscal support, which can pay for itself
 - Absent fiscal slack, design reforms carefully: initial conditions matter

Critically, fiscal space can facilitate reforms

- A key synergy is the *political economy channel*
- The fiscal space that reforms generate can be used to buy support up front – e.g., targeted tax cuts—and the package can *still* entail a fall in *Debt/GDP* ...
- ... less than without fiscal backup, but dominates no reform!
- Policy packages that compensate interest groups
 - Example: Australian GST of 2000
 - *Trade policy is an especially relevant case!*
- Supporting trade adjustment requires myriad policies: worker re-tooling can support trade—but also pension reform
- We at the IMF are also starting to examine what has worked

Fiscal, structural, monetary: How complementary?

- Reforms can be done alongside fiscal consolidation (e.g., Finland in 1990s), but difficult
- Especially hard when economy is in recession
- Poor quality fiscal adjustment (e.g., infrastructure cuts) can hurt structural reform efficacy
- Monetary policy accommodation can help
 - Adhikari et al. (IMF WP, August 2016), show that of five 1990s reformers, only NZ reformed under restrictive fiscal and monetary—trying to lower inflation, at a steep output cost
- Helps reforms to pay off quickly, and thereby generate momentum for further reforms

How to handle moral hazard?

- Monetary accommodation could allow governments to postpone hard reform choices, fiscal and structural
- For example, euro liquidity 1999-2007—DE a big exception
- This is why the paper stresses credible commitment to structural measures before fiscal support is provided
- If moral hazard prevails, economic theory says: attack it *at its source*—not by distorting macro policies or allowing a crisis
- Time-consistent rules that efficiently limit moral hazard require changes in the euro architecture that may need to wait until crisis legacies are resolved and reforms are further along
- **Bringing me full circle—to the need for complementary policies**

Vielen Dank!