Fiscal Policy and the Global Crisis

Presentation at Koç University, Istanbul

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Two fiscal questions

- What is the appropriate fiscal policy in the short term… and what does this imply for the fiscal outlook?
- What are the key elements of a fiscal strategy to ensure fiscal solvency?
John Maynard Keynes
Charles Ponzi
Here is the Challenge

- To allow fiscal policy to support the economy
- While reassuring markets that this is not a Ponzi scheme
Growth Projections

Real GDP Growth
(in percent; QoQ; saar)

Emerging and Developing economies

Advanced economies

World

2006 2007 2008 2009 2010
Unemployment Rate Projections

Unemployment Rate
(in percent)

Euro area
U.K.
U.S.
Japan

2006 2007 2008 2009 2010
What roles can government play?

- Interventions to address the financial sector problems
- Fiscal policy to support aggregate demand
Support Measures with Immediate Effect on Government Debt

Average Upfront Financing, G-20 Advanced Economies

- Purchase of Assets and Lending by Treasury
- Capital Injection

United Kingdom
Japan
Canada
Korea
United States
Spain
Germany
France
Saudi Arabia
Russia
Argentina
Italy
Australia
India
China
Turkey
Indonesia
Brazil

(In percent of GDP)
Gross and Net Fiscal Cost of Banking Crises

(in Percent of GDP)

Source: Laeven and Valencia (2008), Japan Deposit Insurance Corporation, Hoelscher and Quintyn (2003), and IMF staff estimates.
Support without Immediate Effect on Government Debt

- Central Bank Support and Liquidity Provision
- Guarantees

In percent of GDP

- G-20 countries
- Advanced economies
- Emerging economies
- G-20 countries
- Advanced economies
- Emerging economies
Fiscal Stimulus

Implementation of fiscal stimulus in advanced and emerging economies that have fiscal space

- Timely
- Large
- Lasting
- Diversified
- Contingent
- Collective
- Sustainable
Fiscal Policy for the Crisis

Antonio Spilimbergo, Steve Symansky, Olivier Blanchard, and Carlo Cottarelli
Fiscal Implications Out of the Control of Governments

- Automatic stabilizers
- Strong decline in asset prices and commodity prices
- Crisis impact on funded pension schemes
Pension Plan Assets by Country, End-2007

- South Africa
- Hong Kong
- Chile
- Brazil
- Argentina
- United States
- United Kingdom
- Switzerland
- Sweden
- Norway
- Netherlands
- Mexico
- Japan
- Ireland
- Iceland
- France
- Finland
- Denmark
- Canada
- Australia

Total pension assets (percent of GDP):

Asset allocation (percent equities and mutual funds)
Intervention to Support Aggregate Demand
(2008-2010)
Automatic Stabilizers, Other Nondiscretionary Factors, and Discretionary Measures

Emerging G-20 countries
- Automatic Stabilizers
- Other Nondiscretionary Factors
- Discretionary Measures

Advanced G-20 countries
- Automatic Stabilizers
- Other Nondiscretionary Factors
- Discretionary Measures

G-20 countries
- Automatic Stabilizers
- Other Nondiscretionary Factors
- Discretionary Measures
Intervention to Support Aggregate Demand

G-20 Countries: Discretionary Measures, 2009

United States
United Kingdom
Turkey
South Africa
Saudi Arabia
Russia
Mexico
Korea
Japan
Italy
Indonesia
India
Germany
France
China
Canada
Brazil
Australia
Argentina

Annual average, G-20 countries: 2 percent of GDP
Outlook for Public Finances in Advanced G-20 Countries

(In percent of GDP)
Outlook for Public Finances in Emerging Market G-20 Countries

(In percent of GDP)

Fiscal deficit (left scale)

Government debt (right scale)
Prolonged Slowdown/Higher Interest Rate/Contingent Liability Shock

Government Debt (In percent of GDP) 1/

Advanced G-20 Countries

Emerging Market G-20 Countries

Alternative scenario

Base case

Source: IMF staff estimates.

1/ Figure reports results of a 2 percentage point decline in growth, and a 200 basis point increase in real interest rates relative to the baseline starting in 2009; as well as a contingent liability shock corresponding to expected cost of guarantees (column A in Table A4.1 in Appendix IV). Averages based on PPP GDP weights.
How worried should we be?
5-year Sovereign Credit Default Swap (CDS) Spreads in Selected Advanced G-20 Countries

(In basis points)
Nominal Yields

10 Year Government Bond Yields in Selected G20 Countries
(In percentage points)
Fiscal Solvency

- Confidence in governments’ solvency has been a source of stability
- Critical to ensure that challenging fiscal outlook does not raise doubts about solvency
What should be done?
INTERNATIONAL MONETARY FUND

The State of Public Finances:
Outlook and Medium-Term Policies After the 2008 Crisis

Prepared by the Fiscal Affairs Department

In cooperation with other departments

Approved by Carlo Cottarelli

March 6, 2009

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Four-Pillar Strategy: I

- Fiscal stimulus
  - Temporary measures…
  - ….but because the decline in private sector demand is likely to be long-lasting, prolonged measures
  - Avoid permanent raise in fiscal deficits
Four-Pillar Strategy: II

- Medium-term fiscal frameworks
  - Fiscal rules
  - Revisions to Budgetary procedures
  - Introduction of fiscal councils
  - Manage and ultimately dispose of financial sector assets acquired

Governments should commit to tighten fiscal policy in future good times, now that fiscal policy has been relaxed during bad ones.
Four-Pillar Strategy: III

- Structural reforms to enhance growth

Emerging Market Economies: Selected Debt Reduction Episodes
(in percent of GDP)

<table>
<thead>
<tr>
<th>Country/Time period</th>
<th>Initial level of debt</th>
<th>Debt reduction</th>
<th>Primary surplus</th>
<th>Growth - interest rate differential</th>
<th>Real exchange rate appreciation</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland (1993-98)</td>
<td>84.3</td>
<td>47.7</td>
<td>3.3</td>
<td>22.6</td>
<td>9.6</td>
<td>12.1</td>
</tr>
<tr>
<td>Chile (1990-1998)</td>
<td>45.9</td>
<td>33.0</td>
<td>30.0</td>
<td>11.5</td>
<td>3.9</td>
<td>-12.5</td>
</tr>
<tr>
<td>Ecuador (1988-1990)</td>
<td>113.5</td>
<td>32.1</td>
<td>4.1</td>
<td>11.4</td>
<td>-11.8</td>
<td>28.4</td>
</tr>
<tr>
<td>Pakistan (2001-07)</td>
<td>84.8</td>
<td>29.7</td>
<td>6.4</td>
<td>17.1</td>
<td>5.1</td>
<td>1.0</td>
</tr>
<tr>
<td>Egypt (2003-07)</td>
<td>114.9</td>
<td>27.7</td>
<td>-11.0</td>
<td>29.9</td>
<td>1.9</td>
<td>6.8</td>
</tr>
<tr>
<td>Jamaica (2002-07)</td>
<td>122.0</td>
<td>27.4</td>
<td>50.8</td>
<td>-30.3</td>
<td>3.8</td>
<td>3.2</td>
</tr>
<tr>
<td>Brazil (2002-05)</td>
<td>85.0</td>
<td>20.8</td>
<td>12.4</td>
<td>1.7</td>
<td>4.6</td>
<td>2.1</td>
</tr>
<tr>
<td>Colombia (2002-07)</td>
<td>49.8</td>
<td>16.4</td>
<td>14.4</td>
<td>1.0</td>
<td>4.6</td>
<td>-3.6</td>
</tr>
<tr>
<td>Malaysia (2003-07)</td>
<td>44.4</td>
<td>14.5</td>
<td>-4.3</td>
<td>8.3</td>
<td>2.4</td>
<td>8.1</td>
</tr>
<tr>
<td>Tunisia (2001-07)</td>
<td>62.7</td>
<td>11.8</td>
<td>-0.7</td>
<td>8.1</td>
<td>6.4</td>
<td>-2.0</td>
</tr>
<tr>
<td>Average (unweighted)</td>
<td>80.7</td>
<td>26.1</td>
<td>10.6</td>
<td>8.1</td>
<td>3.0</td>
<td>4.4</td>
</tr>
</tbody>
</table>

Sources: IMF, World Economic Outlook; and IMF staff estimates
Four-Pillar Strategy: IV

- Tackle long-run pressures from population aging

Net Present Value of Impact on Fiscal Deficit of Crisis and Aging-Related Spending

Aging

Crisis

(In percent of GDP)
## Four-Pillar Strategy: IV

- Tackle long-run pressures from population aging

### Net Present Value of Impact on Fiscal Deficit of Crisis and Aging-Related Spending

(In percent of GDP, unless otherwise indicated) 1/ , 2/

<table>
<thead>
<tr>
<th>Country</th>
<th>Crisis</th>
<th>Aging</th>
<th>Crisis/Aging</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>28</td>
<td>482</td>
<td>5.8</td>
</tr>
<tr>
<td>Canada</td>
<td>18</td>
<td>726</td>
<td>2.5</td>
</tr>
<tr>
<td>France</td>
<td>30</td>
<td>276</td>
<td>10.9</td>
</tr>
<tr>
<td>Germany</td>
<td>27</td>
<td>280</td>
<td>9.7</td>
</tr>
<tr>
<td>Italy</td>
<td>34</td>
<td>169</td>
<td>20.3</td>
</tr>
<tr>
<td>Japan</td>
<td>35</td>
<td>158</td>
<td>22.1</td>
</tr>
<tr>
<td>Korea</td>
<td>20</td>
<td>683</td>
<td>2.9</td>
</tr>
<tr>
<td>Mexico</td>
<td>13</td>
<td>261</td>
<td>4.8</td>
</tr>
<tr>
<td>Spain</td>
<td>37</td>
<td>652</td>
<td>5.6</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>37</td>
<td>335</td>
<td>11.1</td>
</tr>
<tr>
<td>United States</td>
<td>34</td>
<td>495</td>
<td>6.9</td>
</tr>
<tr>
<td>Advanced G-20 Countries</td>
<td>32</td>
<td>409</td>
<td>10.1</td>
</tr>
</tbody>
</table>

Source: IMF staff estimates.

1/ Table reports net present value of the impact on fiscal balance of the crisis and of aging-related spending increases reported in Table 6.1. The third column reports the ratio of the first column to the second column in percent. The discount rate used is 1 percent a year in excess of GDP growth for each country. Given that real growth is expected to average 3 percent a year, this is equivalent to applying an average real discount rate of 4 percent a year. For years after 2050, the calculation assumes the impact is the same as in 2050.

2/ Averages based on PPP GDP weights.
Thank you!