Comments on "The Effects of Fiscal Policy: What Have We Learned?

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* The views expressed are personal and do not necessarily represent those of the IMF or IMF Policy.

Four Main Results:

1. Tax changes have large effects on economic activity.
2. Balanced budget tax cuts are expansionary.
3. Anticipated tax cuts (increases) are contractionary (expansionary).
4. Different tax instruments have different effects.

How Large are Fiscal Multipliers?

Size of Government Revenue Fiscal Multipliers

	All Samples		United States		Europe	
	VAR	DSGE	VAR	DSGE	VAR	DSGE
Mean	0.2	0.3	0.7	0.3	-0.3	0.1
Median	0.3	0.2	0.7	0.2	-0.3	0.1
Mode	0.7	0.2	0.7	0.2	…	0.1
Maximum	1.4	1.0	1.4	1.0	0.4	0.3
Minimum	-1.5	0.0	-0.7	0.0	-1.5	0.0

Size of Government Spending Fiscal Multipliers

	All Samples		United States		Europe	
	VAR	DSGE	VAR	DSGE	VAR	DSGE
Mean	0.9	0.7	1.0	0.7	0.8	0.6
Median	0.8	0.6	0.9	0.7	0.6	0.5
Mode	0.6	0.5	0.6	…	0.5	0.5
Maximum	2.1	1.9	2.0	1.6	1.5	1.5
Minimum	0.4	0.0	0.4	0.0	0.5	0.1

Source: IMF Fiscal Monitor (April 2012), based on Baunsgaard and others (2012)

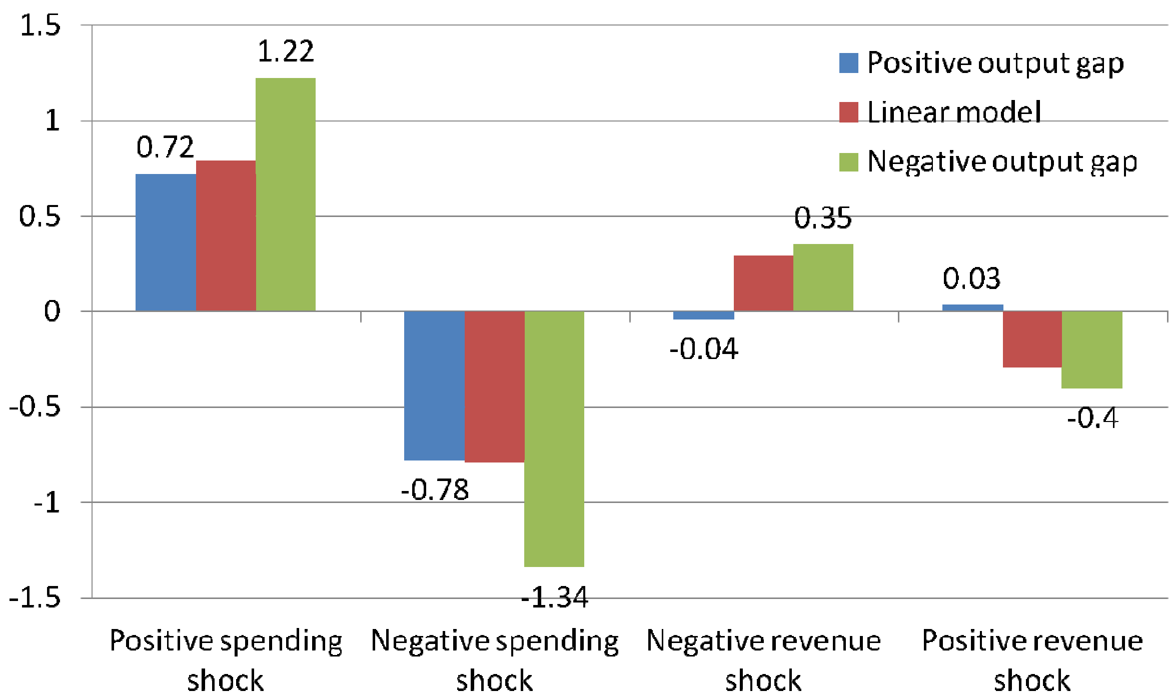
Note: The summary statistics reflect results from 34 studies between 2002 and 2012 with large outliers excluded.

Why do estimates vary so widely?

- Multipliers reflect the relationship b/n (exogenous and temporary) fiscal shocks and output
- This relationship depends on many factors:
  - Cyclical position of the economy and its partners
  - Private debt, bank deleveraging, credit constraints
  - Public debt and bond yields (through confidence effects)
  - Size of automatic stabilizers
  - MP reaction, ER regime, openness, market flexibility
- To discern the right multiplier size, one needs to account for all these factors
- Identification: coefficient restrictions vs. narrative

Fiscal Multipliers in a Recession, G-7

(from the IMF's Fiscal Monitor, April 2012)



Short-Term Multipliers are not everything, though…

- Many other factors affect the design of adjustment:
  - unsustainable policies need to be addressed
  - access to financing determines the pace as well
  - long-term effects on potential output matter, too
  - the size of government affects the choice of adjustment instruments

Effects of Different Tax Instruments

- Differential effect well established (OECD (2008))
- Intuition: the more elastic the tax base, the larger the (change in) the distortion caused by the (change in) the tax
- Usual ranking: (from the smallest distortion):
  - Real estate taxes
  - Consumption taxes
  - Taxes on labor
  - Taxes on capital

Tax rebalancing (a.k.a. Fiscal Devaluation)

- The term is new, the policy is not – many CEECs have cut direct taxes in the 2000s while preserving or raising consumption and RE ones
- Useful to exploit the differences in relative distortions in a revenue-neutral way
- Studies:
  - De Mooij and Keen (2012) –positive ST effects on both exports and growth in the EA;
  - Barkbu, Rahman, Valdes, and a team (2012, IMF SDN) – GDP and exports in the EA can be raised somewhat under certain conditions.