Fiscal Policy for Economic Recovery: Exit Strategy

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Great Recession: Varieties of G-20 Deceleration Experience

- In some countries deceleration in 2008 Q4 after Lehman Brother collapse in September
- In other countries deceleration started a year earlier: 2007 Q2 or Q3
  - In countries like USA, France triggered by early crisis events: US housing market loan default
  - In other countries like India, Australia, triggered by other factors: spike in fuel & petroleum prices
  - Their deceleration intensified following crisis
- G-20 Stimulus packages closely coordinated, mostly launched post-Lehman collapse
- In some countries launched earlier
  - India ‘official’ package in 2008 Q4 only 0.5% GDP
  - Much larger stimulus from fiscal deficit in 2008-09 budget, February 2008: over 5% GDP
Great Recession: Varieties of G-20 Deceleration Experience

- Response lags to stimulus varied greatly:
  - In 9 countries recovery started within 2 quarters
  - In countries like Turkey, Italy within 1 quarter
  - In other countries after 5-6 quarters
  - In India, Indonesia recovery lag was 3 quarters

- Response lags varied for several reasons
  - Differences in severity of crisis
  - Differences in size and composition of stimulus
  - Differences in other economic conditions
Great Recession: Varieties of G-20 Deceleration Experience

Figure 1: G20 Countries: Growth Deceleration, Stimulus and Recovery

Note: Beginning of Growth Deceleration (--------), Beginning of Stimulus (…..…..) & Beginning of Recovery (---).
## Great Recession: Varieties of G-20 Deceleration Experience

### Table 1: G-20 Countries: Timing and Intensity of Growth Deceleration and Recovery

<table>
<thead>
<tr>
<th>Country</th>
<th>Time of Deceleration</th>
<th>Time of first Stimulus</th>
<th>Time Lag</th>
<th>Time of Recovery</th>
<th>Time Lag</th>
<th>Average Annual Growth Rate&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Minimum Growth Rate&lt;sup&gt;2&lt;/sup&gt;</th>
<th>Maximum Deceleration</th>
<th>Size of Stimulus (in Billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>2008Q3</td>
<td>2008Q4</td>
<td>1 Quarter</td>
<td>2009Q4</td>
<td>4 Quarters</td>
<td>5.93</td>
<td>-4.16</td>
<td>31.16</td>
<td>6.5 US$</td>
</tr>
<tr>
<td>India</td>
<td>2007Q2</td>
<td>2008Q1</td>
<td>3 Quarters</td>
<td>2009Q1</td>
<td>4 Quarters</td>
<td>9.60</td>
<td>5.76</td>
<td>40.57</td>
<td>4.1 US$</td>
</tr>
<tr>
<td>China Mainland</td>
<td>2007Q4</td>
<td>2008Q4</td>
<td>4 Quarters</td>
<td>2009Q2</td>
<td>2 Quarters</td>
<td>11.70</td>
<td>6.10</td>
<td>48.23</td>
<td>196 US$</td>
</tr>
<tr>
<td>Australia</td>
<td>2007Q2</td>
<td>2008Q4</td>
<td>6 Quarters</td>
<td>2009Q4</td>
<td>4 Quarters</td>
<td>3.31</td>
<td>0.87</td>
<td>77.62</td>
<td>52.4 US$</td>
</tr>
<tr>
<td>Saudi Arabia&lt;sup&gt;3&lt;/sup&gt;</td>
<td>2008Q4</td>
<td>2008Q4</td>
<td>0 Quarter</td>
<td>2010Q1</td>
<td>5 Quarters</td>
<td>3.77</td>
<td>0.15</td>
<td>96.02</td>
<td>17.5 US$</td>
</tr>
<tr>
<td>Argentina</td>
<td>2008Q3</td>
<td>2008Q4</td>
<td>1 Quarter</td>
<td>2009Q3</td>
<td>3 Quarters</td>
<td>8.55</td>
<td>-0.77</td>
<td>109</td>
<td>36.5 US$</td>
</tr>
<tr>
<td>Brazil</td>
<td>2008Q3</td>
<td>2008Q4</td>
<td>1 Quarter</td>
<td>2009Q2</td>
<td>2 Quarters</td>
<td>4.85</td>
<td>-2.13</td>
<td>143.95</td>
<td>94.8 US$</td>
</tr>
<tr>
<td>South Africa</td>
<td>2008Q2</td>
<td>2009Q1</td>
<td>3 Quarters</td>
<td>2009Q3</td>
<td>2 Quarters</td>
<td>5.36</td>
<td>-2.47</td>
<td>147.77</td>
<td>3.7 US$</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>2008Q1</td>
<td>2008Q4</td>
<td>3 Quarters</td>
<td>2009Q2</td>
<td>2 Quarters</td>
<td>4.79</td>
<td>-4.30</td>
<td>189.61</td>
<td>11 US$</td>
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<tr>
<td>Canada</td>
<td>2007Q4</td>
<td>2009Q1</td>
<td>5 Quarters</td>
<td>2009Q3</td>
<td>2 Quarters</td>
<td>2.68</td>
<td>-3.18</td>
<td>218.52</td>
<td>43.5 US$</td>
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<tr>
<td>United States</td>
<td>2007Q3</td>
<td>2009Q1</td>
<td>6 Quarters</td>
<td>2009Q3</td>
<td>2 Quarters</td>
<td>2.63</td>
<td>-3.83</td>
<td>245.23</td>
<td>787 US$</td>
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<tr>
<td>Russian Federation</td>
<td>2008Q1</td>
<td>2008Q4</td>
<td>3 Quarters</td>
<td>2009Q3</td>
<td>3 Quarters</td>
<td>7.44</td>
<td>-10.94</td>
<td>247.11</td>
<td>20 US$</td>
</tr>
<tr>
<td>France</td>
<td>2007Q3</td>
<td>2008Q4</td>
<td>5 Quarters</td>
<td>2009Q2</td>
<td>2 Quarters</td>
<td>2.24</td>
<td>-3.93</td>
<td>275.42</td>
<td>33 US$</td>
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<tr>
<td>Turkey</td>
<td>2008Q1</td>
<td>2009Q1</td>
<td>4 Quarters</td>
<td>2009Q2</td>
<td>1 Quarter</td>
<td>6.75</td>
<td>-14.45</td>
<td>314.23</td>
<td>9.84 US$</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2008Q1</td>
<td>2008Q4</td>
<td>3 Quarters</td>
<td>2009Q3</td>
<td>3 Quarters</td>
<td>2.52</td>
<td>-5.90</td>
<td>334.2</td>
<td>30 US$</td>
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<tr>
<td>Mexico</td>
<td>2008Q2</td>
<td>2009Q1</td>
<td>3 Quarters</td>
<td>2009Q3</td>
<td>2 Quarters</td>
<td>3.68</td>
<td>-9.97</td>
<td>371.03</td>
<td>20 US$</td>
</tr>
<tr>
<td>Germany</td>
<td>2008Q1</td>
<td>2008Q4</td>
<td>3 Quarters</td>
<td>2009Q2</td>
<td>2 Quarters</td>
<td>2.34</td>
<td>-6.70</td>
<td>386.66</td>
<td>29 US$</td>
</tr>
<tr>
<td>Japan</td>
<td>2007Q1</td>
<td>2008Q3</td>
<td>6 Quarters</td>
<td>2009Q2</td>
<td>3 Quarters</td>
<td>2.10</td>
<td>-8.57</td>
<td>508.48</td>
<td>150 US$</td>
</tr>
<tr>
<td>Italy</td>
<td>2007Q3</td>
<td>2009Q1</td>
<td>6 Quarters</td>
<td>2009Q2</td>
<td>1 Quarter</td>
<td>1.55</td>
<td>-6.52</td>
<td>519.56</td>
<td>2.56 US$</td>
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</tbody>
</table>

Source: Authors’ calculation based on GDP data from IMF, IFS, July 2010. Size and timing of stimulus for each country collected from respective country reports and various press releases (see Appendix-A).

Notes: 1- Simple average growth rate based on GDP data from 2004:Q1 to one quarter before the time of deceleration.
2- Growth rate when the country experienced maximum fall in the GDP growth rate.
3- Interpolation method has been used to derive the quarterly numbers for Saudi Arabia.
Readiness for Stimulus Withdrawals

• Readiness for stimulus withdrawal varies, depending on several factors
  - Growth situation
  - Investment climate
  - Other macro economic conditions

• G-20 coordination essential, but ‘one size fits all’ approach very risky
  - Negative shock of simultaneous stimulus could trigger double dip recession
  - Conversely postponement of stimulus withdrawal can fan inflation in fast growing countries.
Readiness for Stimulus Withdrawal

- Advance countries not ready for stimulus withdrawal since recovery weak and uncertain

- Risk of double digit recession with premature monetary tightening where financial sector still fragile
- High public debt and large, rising deficit makes compression urgent
- In some cases large external sovereign debt meant high insolvency risk: Greece, Ireland, Spain, Portugal, Italy, etc.
- Must announce credible spending policies to indogenize future spending reversals e.g., extending retirement age by 2 years could reduce public debt ratio by 40%.
Readiness for Stimulus Withdrawals

- Most emerging market G-20 countries growing fast (>5%, mostly 8%+)
  - Stimulus withdrawal urgent in countries like India where inflation is high
  - In most cases focus on fiscal compression (deficit reduction)
  - In India high public debt & large fiscal deficit makes compression urgent
  - Since financial sector robust (low NPL) and well regulated, monetary tightening also feasible and ongoing in India
### Table 2: G20 Countries: Selected Macroeconomic Indicators

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP Growth 2010 Q1</th>
<th>Inflation Rate 2010 Q1</th>
<th>Primary Balance as % of GDP 2009</th>
<th>Gross Government Debt as % of GDP 2009</th>
<th>Non-Performing Loans as % of Total Loans 2009</th>
<th>Current Account Balance as % of Total Reserve Assets 2009</th>
<th>Short-term Gross External Debt of Govt as % of Total Reserve Assets 2010 Q1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey</td>
<td>H (11.65)</td>
<td>P (9.29)</td>
<td>M (-1.0)</td>
<td>M (45.5)</td>
<td>L (-6.07)</td>
<td>L (-0.07)</td>
<td>H (0.0)</td>
</tr>
<tr>
<td>Brazil</td>
<td>H (8.95)</td>
<td>M (4.86)</td>
<td>H (2.1)</td>
<td>L (68.9)</td>
<td>L (4.5)</td>
<td>L (-5.13)</td>
<td>H (0.0)</td>
</tr>
<tr>
<td>China</td>
<td>H (8.70) 2</td>
<td>H (2.20)</td>
<td>M (-2.60)</td>
<td>H (18.9)</td>
<td>H (1.6)</td>
<td>H (12.25)</td>
<td>-</td>
</tr>
<tr>
<td>India</td>
<td>H (8.60)</td>
<td>P (15.32)</td>
<td>L (-4.90)</td>
<td>P (80.8)</td>
<td>M (2.4)</td>
<td>L (-4.30)</td>
<td>H (0.54)</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>H (8.10)</td>
<td>H (2.69)</td>
<td>H (1.50)</td>
<td>H (32.6)</td>
<td>H (1.5)</td>
<td>H (3.91)</td>
<td>H (0.0)</td>
</tr>
<tr>
<td>Argentina</td>
<td>H (6.76)</td>
<td>P (9.02)</td>
<td>H (0.20)</td>
<td>M (59.8)</td>
<td>M (3.1)</td>
<td>H (3.12)</td>
<td>M (14.66)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>H (5.69)</td>
<td>M (3.43)</td>
<td>H (0.10)</td>
<td>H (28.6)</td>
<td>M (3.8)</td>
<td>H (5.45)</td>
<td>H (0.0)</td>
</tr>
<tr>
<td>Mexico</td>
<td>M (4.30)</td>
<td>M (4.75)</td>
<td>M (-1.40)</td>
<td>M (44.9)</td>
<td>M (3.4)</td>
<td>M (-0.69)</td>
<td>H (2.87)</td>
</tr>
<tr>
<td>Japan</td>
<td>M (4.22)</td>
<td>H (-1.16)</td>
<td>P (-9.10)</td>
<td>P (217.7)</td>
<td>H (1.8)</td>
<td>H (0.00)</td>
<td>L (24.28)</td>
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<tr>
<td>Australia</td>
<td>M (2.71)</td>
<td>H (2.89)</td>
<td>L (-4.10)</td>
<td>H (15.5)</td>
<td>H (1.1)</td>
<td>P (-20.64)</td>
<td>H (3.58)</td>
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<tr>
<td>United States</td>
<td>L (2.50)</td>
<td>H (2.36)</td>
<td>P (-10.70)</td>
<td>P (83.2)</td>
<td>L (5.4)</td>
<td>M (-0.08)</td>
<td>P (574.11)</td>
</tr>
<tr>
<td>Canada</td>
<td>L (2.21)</td>
<td>H (1.61)</td>
<td>L (-5.10)</td>
<td>P (82.5)</td>
<td>H (1.2)</td>
<td>P (-10.31)</td>
<td>L (43.54)</td>
</tr>
<tr>
<td>Germany</td>
<td>L (1.52)</td>
<td>H (0.81)</td>
<td>M (-0.90)</td>
<td>L (72.5)</td>
<td>M (2.8)</td>
<td>H (0.04)</td>
<td>P (60.46)</td>
</tr>
<tr>
<td>South Africa</td>
<td>L (1.43)</td>
<td>M (5.65)</td>
<td>L (-3.60)</td>
<td>H (31.5)</td>
<td>L (5.5)</td>
<td>L (-6.41)</td>
<td>H (0.0)</td>
</tr>
<tr>
<td>France</td>
<td>L (1.21)</td>
<td>H (1.32)</td>
<td>L (-5.80)</td>
<td>L (77.4)</td>
<td>M (2.8)</td>
<td>M (-0.02)</td>
<td>P (190)</td>
</tr>
<tr>
<td>Italy</td>
<td>L (0.48)</td>
<td>H (1.29)</td>
<td>M (-0.80)</td>
<td>P (115.8)</td>
<td>P (6.2)</td>
<td>P (-18.96)</td>
<td>P (75.47)</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>L (0.15) 2</td>
<td>M (4.47)</td>
<td>M (-1.40)</td>
<td>H (16.3)</td>
<td>H (1.4)</td>
<td>H (5.55)</td>
<td>-</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>P (-0.23)</td>
<td>M (3.95)</td>
<td>P (-9.10)</td>
<td>L (68.2)</td>
<td>M (3.3)</td>
<td>M (-0.00)</td>
<td>L (46.95)</td>
</tr>
<tr>
<td>Spain</td>
<td>P (-1.30)</td>
<td>H (1.10)</td>
<td>P (-10.10)</td>
<td>M (55.2)</td>
<td>L (5.1)</td>
<td>P (-76.52)</td>
<td>P (250.06)</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>P(-8.90) 3</td>
<td>L (7.21)</td>
<td>L (-5.90)</td>
<td>H (9.0)</td>
<td>P (9.6)</td>
<td>H (3.63)</td>
<td>H (0.10)</td>
</tr>
</tbody>
</table>

H = High, M = Medium, L = Low, P = Poor

GDP growth: H >5%, M >5% and <2.5%, L 0<2.5% P <0%
Inflation: H <3%, M 3% <6%, L 6% <9%, P >9%
Primary Balance: H >0%, M 0<(3%), L (-3%) <(-6%), P <(-6%)
Non-performing Loans/Total Loans: H <2%, M 2% <4%, L 4% <6%, P >6%
Current account balance/reserves: H >0%, M 0 <(-4%), L 4% <(-8%), P <(-8%)
Short-term external debt of the government/reserves: H <5%, M 5% <20%, L 20% <50%, P >50%
Fiscal Consolidation with High Inclusive Growth

• 13th FC recommended reduction of public debt from 79% GDP (2009-10) to 68% (2014-15)
  - This implies reduction in combined deficit (Centre + States) from 9.5% GDP (2009-10) to 5.4% (2014-15)
  - That is medium term compression of 4.1% GDP

• 13th FC further recommended:
  - Central government fiscal deficit 3% by 2014-15
  - Central government capital expenditure to be raised by 2.4% GDP, eliminate revenue deficit
  - States: consolidated deficit of 2.4% GDP
  - Essential logic capital expenditure preserving fiscal compression
  - ‘Crowding in’, and multiplier effect of public investment
Fiscal Consolidation with High Inclusive Growth

• UPA government also desires inclusiveness and high social expenditure, e.g., NCMP targets:
  - Education spending to rise from 3.2% GDP (2009-10) to 6% (2014-15)
  - Health spending to rise from 1.4% GDP (2009-10) to 3% (2014-15)
  - With additional spending on food security, say 5% GDP increase in human development and social protection spending by 2014-15
• Combined with 13th FC recommendation of extra 2.4% GDP capital spending this implies 7.4% GDP increase in social and capital expenditure over medium term
• Challenge:
  - How to reconcile this with 4.1% GDP reduction in overall fiscal deficit over same period?
• This will require 11.5% GDP adjustment in compressing other expenditure and raising revenues
Fiscal Consolidation with High Inclusive Growth

- Subsidy reduction: subsidies amount to around 15% of GDP (Mundle-Rao estimates 1987-88, followed by Srivastava and others)
  - Strong economic case for raising user charges of non-merit, non-public goods
  - Better targeting for food and petroleum subsidies
  - Better recovery of power tariff reduction at state level possible
  - However, subsidy reduction politically difficult
  - Optimistic assumption: 3% GDP savings from subsidies compression over medium term

- 13th FC recommends 1% GDP additional revenues from sale of public sector equity
  - Feasible with 10% public sector equity disinvestment target
Fiscal Consolidation with High Inclusive Growth

- Can balance 6.5% GDP be raised through additional tax revenue?

  - With base broadening abandoned in latest Direct Taxes Code, not much likely in direct taxes
  - Rolling out broad based GST with suitable technology platform can yield spectacular results
  - Introduction of electronic tax information system (TIN) helped raise direct tax ratio from 3.8% GDP in 2003-04 to 6.5% in 2007-08
  - Statistical tests to isolate TIN impact showed increase in direct tax buoyancy (w.r.t. non-agricultural income) from 1.22% to 1.5%
  - Optimistic assumption concerted tax effort may raise tax GDP ratio by 3% over medium term
Fiscal Consolidation with High Inclusive Growth

- Despite Optimistic assumptions about expenditure and revenue adjustments a gap of 3.5% GDP in reconciling deficit reduction target with targets of enhanced social spending and capital spending.

- Loading enter burden of gap adjustment on only 1 of 3 targets not feasible.

- Possible reconciliation is partial adjustment of all 3 targets
  - 7% GDP social spending against 9% NCMP targets
  - 1.9% GDP additional capital spending against 2.4% proposed by 13th FC
  - 7% consolidated deficit instead of 6% proposed by 13th FC.
Thank you