

Fiscal Policy for Economic Recovery: Exit Strategy

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Great Recession: Varieties of G-20 Deceleration Experience

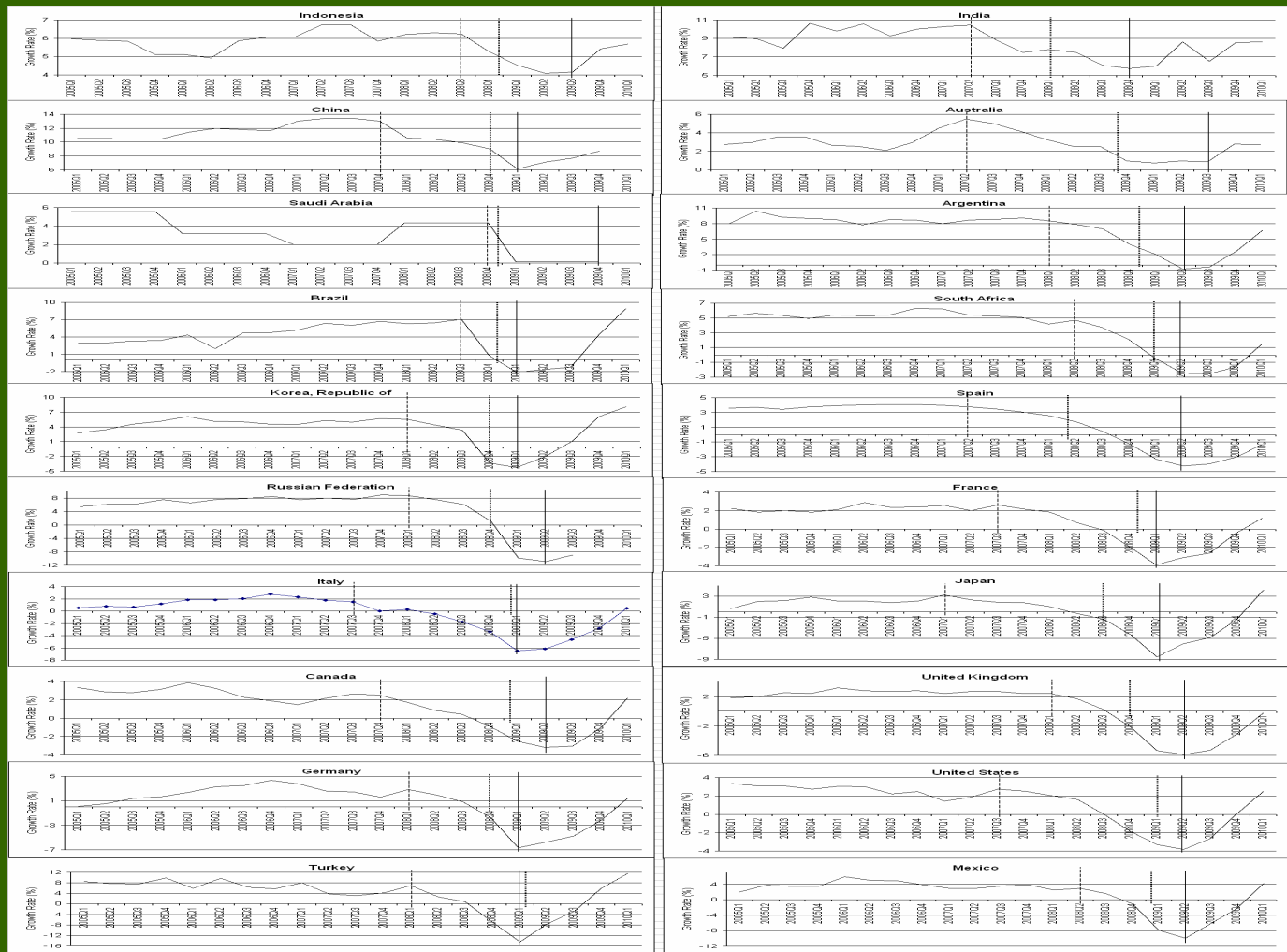
- In some countries deceleration in 2008 Q4 after Lehman Brother collapse in September
- In other countries deceleration started a year earlier: 2007 Q2 or Q3
 - In countries like USA, France triggered by early crisis events: US housing market loan default
 - In other countries like India, Australia, 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 I: G 20 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

Table1: G 20 Countries: Timing and Intensity of Growth Deceleration and Recovery

Country	Time of Deceleration	Time of first Stimulus	Time Lag	Time of Recovery	Time Lag	Average Annual Growth Rate ¹	Minimum Growth Rate ²	Maximum Deceleration	Size of Stimulus (in Billion)
Col(1)	Col(2)	Col(3)	Col(4)= (3)-(2)	Col(5)	Col(6)= (5)-(3)	Col(7)	Col(8)	Col(9) = $100\{[(7)-(8)]/(7)\}$	Col(10)
Indonesia	2008Q3	2008Q4	1 Quarters	2009Q4	4 Quarters	5.93	4.16	31.16	6.5 US\$
India	2007Q2	2008Q1	3 Quarters	2009Q1	4 Quarters	9.60	5.76	40.57	4.1 US\$
China Mainland	2007Q4	2008Q4	4 Quarters	2009Q2	2 Quarters	11.70	6.10	48.23	196 US\$
Australia	2007Q2	2008Q4	6 Quarters	2009Q4	4 Quarters	3.31	0.87	77.62	52.4 US\$
Saudi Arabia ³	2008Q4	2008Q4	0 Quarter	2010Q1	5 Quarters	3.77	0.15	96.02	17.5 US\$
Argentina	2008Q3	2008Q4	1 Quarter	2009Q3	3 Quarters	8.55	-0.77	109	36.5 US\$
Brazil	2008Q3	2008Q4	1 Quarter	2009Q2	2 Quarters	4.85	-2.13	143.95	94.8 US\$
South Africa	2008Q2	2009Q1	3 Quarters	2009Q3	2 Quarters	5.36	-2.47	147.77	3.7 US\$
Korea, Republic of	2008Q1	2008Q4	3 Quarters	2009Q2	2 Quarters	4.79	-4.30	189.61	11 US\$
Spain	2007Q2	2008Q2	4 Quarters	2009Q3	5 Quarters	3.83	-4.22	210.27	29 Euro
Canada	2007Q4	2009Q1	5 Quarters	2009Q3	2 Quarters	2.68	-3.18	218.52	43.5 US\$
United States	2007Q3	2009Q1	6 Quarters	2009Q3	2 Quarters	2.63	-3.83	245.23	787 US\$
Russian Federation	2008Q1	2008Q4	3 Quarters	2009Q3	3 Quarters	7.44	-10.94	247.11	20 US\$
France	2007Q3	2008Q4	5 Quarters	2009Q2	2 Quarters	2.24	-3.93	275.42	33 US\$
Turkey	2008Q1	2009Q1	4 Quarters	2009Q2	1 Quarter	6.75	-14.45	314.23	9.84 US\$
United Kingdom	2008Q1	2008Q4	3 Quarters	2009Q3	3 Quarters	2.52	-5.90	334.2	30 US\$
Mexico	2008Q2	2009Q1	3 Quarters	2009Q3	2 Quarters	3.68	-9.97	371.03	20 US\$
Germany	2008Q1	2008Q4	3 Quarters	2009Q2	2 Quarters	2.34	-6.70	386.66	29 US\$
Japan	2007Q1	2008Q3	6 Quarters	2009Q2	3 Quarters	2.10	-8.57	508.48	150 US\$
Italy	2007Q3	2009Q1	6 Quarters	2009Q2	1 Quarter	1.55	-6.52	519.56	2.56 US\$

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

Readiness for Stimulus Withdrawals

Table 2: G 20 Countries: Selected Macroeconomic Indicators

	GDP Growth ¹	Inflation Rate ⁴	Primary Balance as % of GDP ⁵	Gross Government Debt as % of GDP ⁵	Non-Performing Loans as % of Total Loans ⁶	Current Account Balance as % of Total Reserve Assets ⁸	Short-term Gross External Debt of Govt as % of Total Reserve Assets ¹³
	2010 Q1	2010 Q1	2009	2009	2009	2009 Q4	2010 Q1
Turkey	H (11.65)	P (9.29)	M (-1.0)	M (45.5)	L (5.7)	L (-6.07)	H (0.0)
Brazil	H (8.95)	M (4.86)	H (2.1)	L (68.9)	L (4.5)	L (-5.13)	H (0.0)
China	H (8.70) ²	H (2.20)	M (-2.60)	H (18.9)	H (1.6)	H (12.25) ⁹	-
India	H (8.60)	P(15.32)	L (-4.90)	P (80.8)	M (2.4)	L (-4.30) ¹⁰	H (0.54)
Republic of Korea	H (8.10)	H (2.69)	H (1.50)	H (32.6)	H (1.5)	H (3.91)	H (0.0)
Argentina	H (6.76)	P (9.02)	H (0.20)	M (59.8)	M (3.1)	H (3.12)	M (14.66)
Indonesia	H (5.69)	M (3.43)	H (0.10)	H (28.6)	M (3.8)	H (5.45)	H (0.0)
Mexico	M (4.30)	M (4.75)	M (-1.40)	M (44.9)	M (3.4)	M (-0.69)	H (2.87)
Japan	M (4.22)	H(-1.16)	P (-9.10)	P (217.7)	H (1.8)	H (0.00)	L (24.28)
Australia	M (2.71)	H (2.89)	L (-4.10)	H (15.5)	H (1.1)	P(-20.64) ¹¹	H (3.58)
United States	L (2.50)	H (2.36)	P (-10.70)	P (83.2)	L (5.4)	M (-0.08)	P (574.11)
Canada	L (2.21)	H (1.61)	L (-5.10)	P (82.5)	H (1.2)	P (-10.31)	L (43.54)
Germany	L (1.52)	H (0.81)	M (-0.90)	L (72.5)	M (2.8) ⁷	H (0.04)	P (60.46)
South Africa	L (1.43)	M (5.65)	L (-3.60)	H (31.5)	L (5.5)	L (-6.41)	H (0.0)
France	L (1.21)	H (1.32)	L (-5.80)	L (77.4)	M (2.8) ⁷	M (-0.02)	P (190)
Italy	L (0.48)	H (1.29)	M (-0.80)	P (115.8)	P (6.2)	P(-18.96) ¹²	P(75.47)
Saudi Arabia	L (0.15) ²	M (4.47)	M (-1.40)	H (16.3)	H (1.4) ⁷	H (5.55) ⁹	-
United Kingdom	P (-0.23)	M (3.95)	P (-9.10)	L (68.2)	M (3.3)	M (-0.00)	L (46.95)
Spain	P (-1.30)	H (1.10)	P (-10.10)	M (55.2)	L (5.1)	P(-76.52) ¹²	P (250.06)
Russian Federation	P(-8.90) ³	L (7.21)	L (-5.90)	H(9.0)	P (9.6)	H (3.63)	H (0.10)

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%)

Public Debt/GDP: **H** <40% , **M** 40% < 60% , **L** 60% < 80% , **P** >80%

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%

ShortTerm 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 entire 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