

# Does public spending foster inclusive growth in your country?

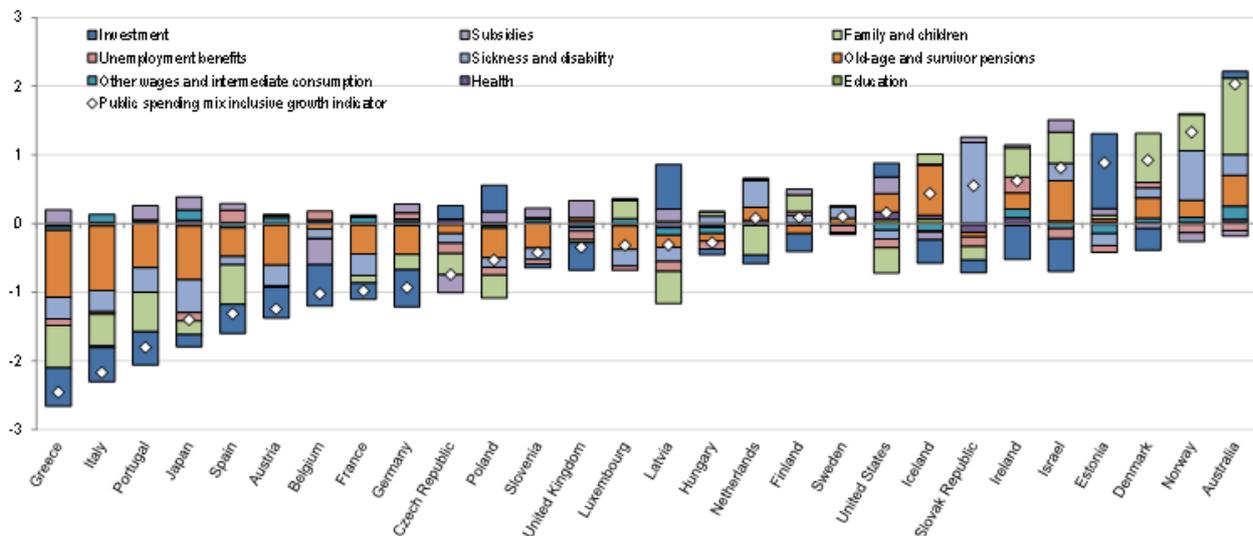
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Governments today need to balance the policy goals of boosting economic growth and improving equity when making budget decisions. How can public spending choices promote inclusive growth? What can be learned from previous spending decisions in times of crisis?

As it becomes increasingly important for policymakers to look at public finances in terms of both growth and income equality, a new set of indicators has been developed to help governments assess how public spending can be geared toward achieving these twin goals.

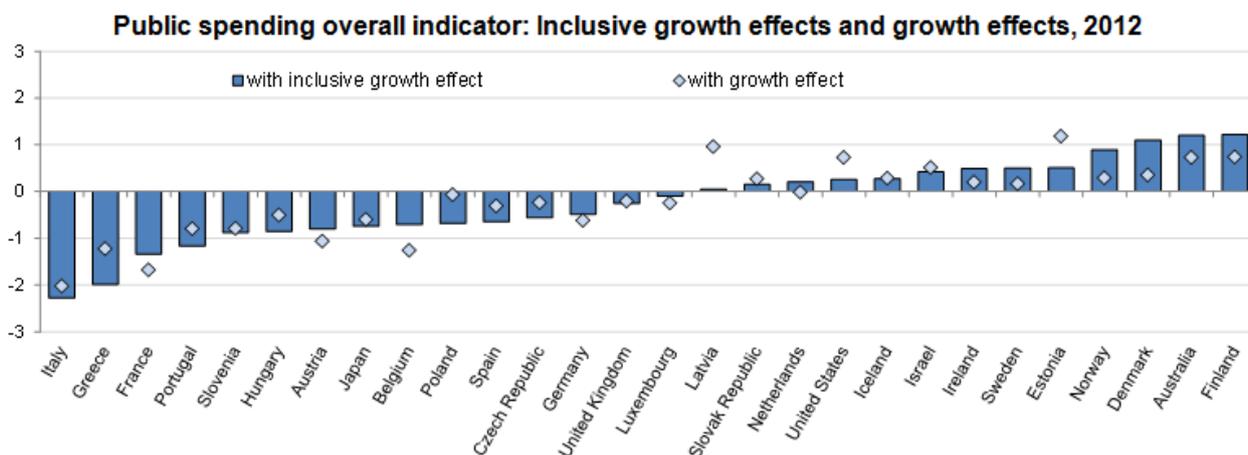
A first set of indicators combines information on the mix of public spending. Each spending item share is multiplied with an estimated coefficient from growth and inequality equations to build both a growth and an income distribution component, which is then summed up to an aggregate inclusive growth indicator. The outcomes show that public investment and family and child benefits help buttress inclusive growth, while old age pensions and government subsidies hurt the most. The indicator below shows that the public spending mix is least conducive to inclusive growth in Greece and most conducive in Australia.

### Components of the public spending mix indicator, 2012



Source: Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", OECD Economics Department Working Papers, No. 1465, OECD Publishing, Paris, <https://doi.org/10.1787/2f6d2e8f-en>

Taking the analysis further, a second set of indicators adds information on the size and effectiveness of governments to the public spending mix analysis, providing an overall indicator on the effects of public spending on inclusive growth. This indicator shows that countries with large but efficient governments, such as Nordic countries, along with those favouring inclusive-growth friendly spending items do well in the indicator ranking, while those with less-effective governments, and with high old-age pension spending tend to do worse.



Source: Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", OECD Economics Department Working Papers, No. 1465, OECD Publishing, Paris, <https://doi.org/10.1787/2f6d2e8f-en>

Policymakers need to be aware of these effects when facing hard choices, particularly during times of economic crisis. Analysis based on these new indicators have shown there is a striking link between the growth component of the public spending mix indicator and the output gap: the capacity of the public finances to support inclusive growth deteriorated markedly in the countries hardest hit during the recent crisis, as governments slashed budgets with little regard to which items would underpin inclusive growth.

What can we take away from this? Countries facing pressure to reduce spending during an economic downturn need to consider which spending items would be most – and least – conducive to inclusive growth, to ultimately help them come out stronger after a crisis. Increasing public investment and family benefits, for example, while targetting reductions in less productive spending items should help assure healthier, fairer economies.

### Reference:

Bloch, D. and J. Fournier (2018), "The Deterioration of the Public Spending Mix during the Global Financial Crisis: Insights from New Indicators", *OECD Economics Department Working Papers*, No. 1465, OECD Publishing, Paris, <https://doi.org/10.1787/2f6d2e8f-en>.

## **Further reading:**

Fournier, J. and Å. Johansson (2016), "The Effect of the Size and the Mix of Public Spending on Growth and Inequality", *OECD Economics Department Working Papers*, No. 1344, OECD Publishing, Paris, <https://doi.org/10.1787/f99f6b36-en>.

Johansson, Å. (2016), "Public Finance, Economic Growth and Inequality: A Survey of the Evidence", *OECD Economics Department Working Papers*, No. 1346, OECD Publishing, Paris, <https://doi.org/10.1787/094bdaa5-en>.

Bloch, D. et al. (2016), "Trends in Public Finance: Insights from a New Detailed Dataset", *OECD Economics Department Working Papers*, No. 1345, OECD Publishing, Paris, <https://doi.org/10.1787/4d3d8b25-en>.