Time to deploy the fiscal levers actively and wisely

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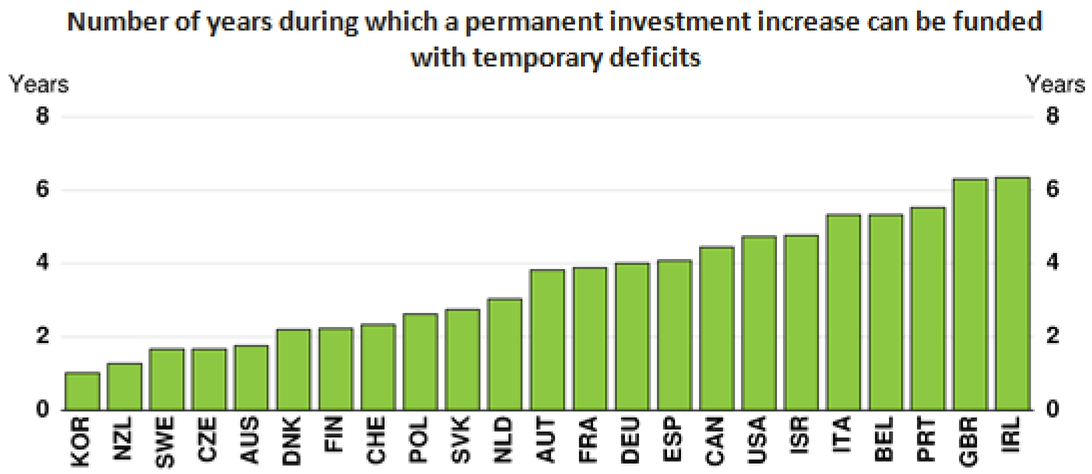
The role of fiscal policy has been at the heart of the policy debate since the financial crisis. With the global economy stuck in a low-growth trap and monetary policy overburdened, it is time to re-assess the use of fiscal policy levers.

Government interest payments have fallen sharply as interest rates have declined to very low levels, freeing up cash. In addition, new OECD estimates show that "fiscal space" – the gap between current government debt and levels at which market access would be compromised – have widened since 2014, as lower interest rates have more than offset headwinds from lower potential growth. This creates a window of opportunity.



Most OECD governments have space to pursue a ½ percent of GDP deficit-financed "fiscal initiative" to support productivity-enhancing measures for 3-4 years without increasing public debt in the medium term. The withdrawal of deficit financing after the initial fiscal initiative and the outcome of higher growth from the initiative are enough to ensure that debt sustainability does not deteriorate, while the low interest rate environment means that stimulus is not crowded out. The benefits are greater if boosting short-term activity helps to avoid high and persistent unemployment, if countries reduce regulatory burdens, and if countries undertake these efforts collectively.

		Contractionary	Mildly contractionary	Broadly neutral	Mildly expansionary	Expansionary
Projected fiscal stance	Contractionary					
	Mildly contractionary		ARG, BRA, COL, CRI, GRC, SVK	BEL	AUS, GBR, IDN, KOR	
	Broadly neutral			CHL, CZE, DNK, ESP, IND, IRL, ISR, JPN, LTU, MEX, NZL, PRT,TUR, SWE, ZAF	AUT, FIN, NLD,FRA, RUS	CHE
	Mildly expansionary	HUN		SVN	CAN, ITA, NOR, POL	DEU, EST, LVA
	Expansionary	ISL			CHN	LUX, USA

OECD recommends more expansionary than planned
OECD recommends less expansionary policy than planned

While it may be easy to relax the fiscal stance, the success of the fiscal initiative to promote growth, enhance long-run potential output, and improve debt sustainability depends on an effective strategy of additional spending or tax reductions to achieve more inclusive and higher growth.

Several major economies are now using the fiscal levers more *actively*, following the consolidation of the years following the crisis. But, some countries – notably in Europe – have yet to seize the opportunity.

However, are countries using the fiscal levers more *wisely?* The evidence of recent years is that many countries have cut the share of spending on investment and education, while increasing the share of taxes that are most harmful to growth and equality. A shift toward a more effective mix is needed.

The OECD is today releasing new research on the mix, size and quality of public investment, including a new dataset on the composition of public spending. Soft investment, such as skills and R&D, together with well-governed public investment in infrastructure, can yield large growth gains. Good institutions enhance the effectiveness of government spending and tax policy.

The policy debate will continue, but now is the time to deploy the fiscal levers actively and wisely !

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