Comments on "**Long-Term Fiscal Sustainability in Major Economies**" by Alan J. Auerbach

Tenth BIS Annual Conference, Fiscal Policy and its Implications for Monetary and Financial Stability

23-34th June 2011

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Chief Economist of the OECD

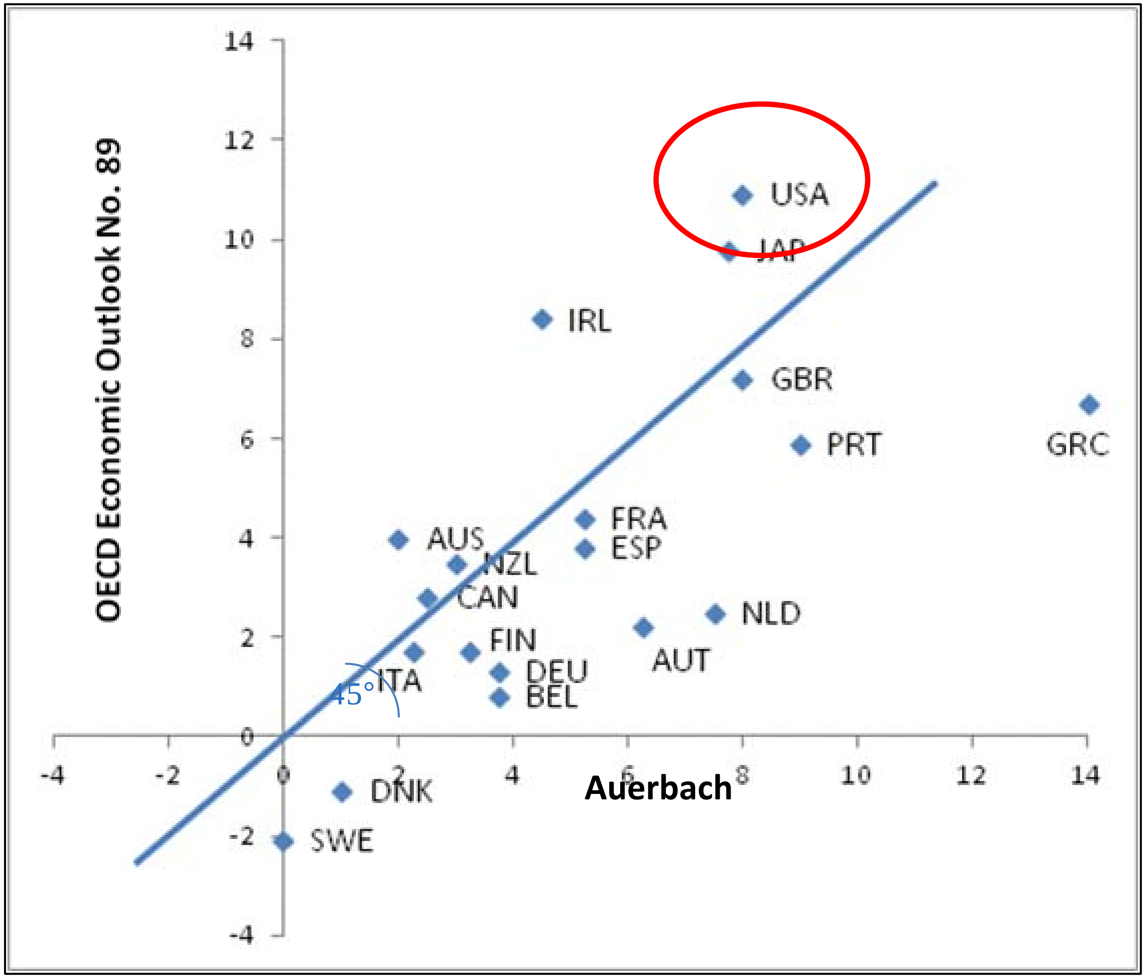
Main messages

- Fiscal consolidation requirements are challenging. This is a main message of the OECD's Economic Outlook and confirmed by Auerbach.
- The price of high public indebtedness is high. Economic stagnation could persist, real interest rates could soar. Fiscal consolidation is inescapable.
- Fiscal consolidation can, and should, be made growth friendly. Emphasis on efficiency (welfare) enhancing expenditure restraint and tax raising.

Baseline fiscal gaps: not identical though similar messages

Comments on Auerbach

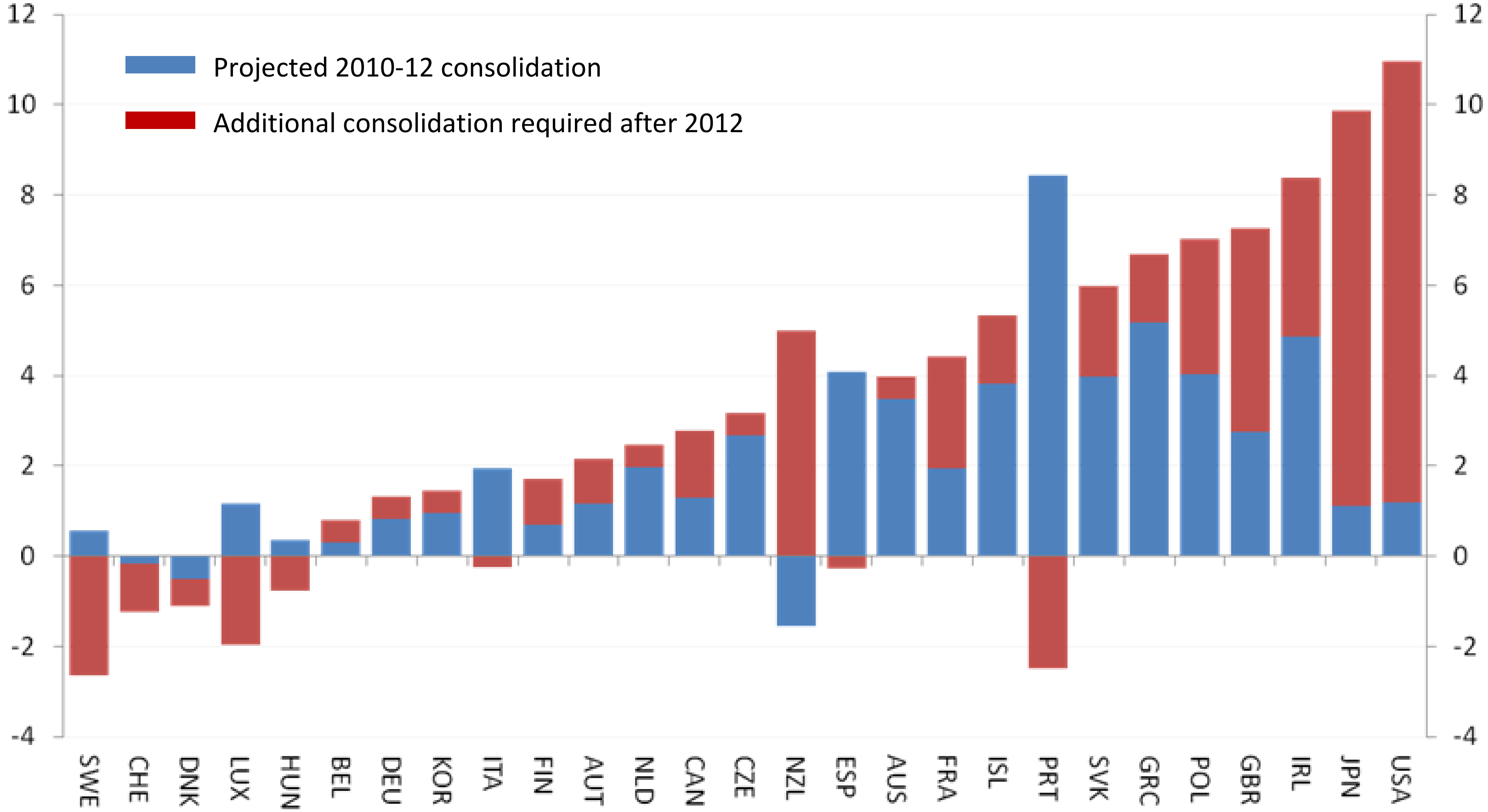
Per cent of GDP



Source: OECD Economic Outlook 89 database, Auerbach 2011.

Substantial fiscal consolidation is planned

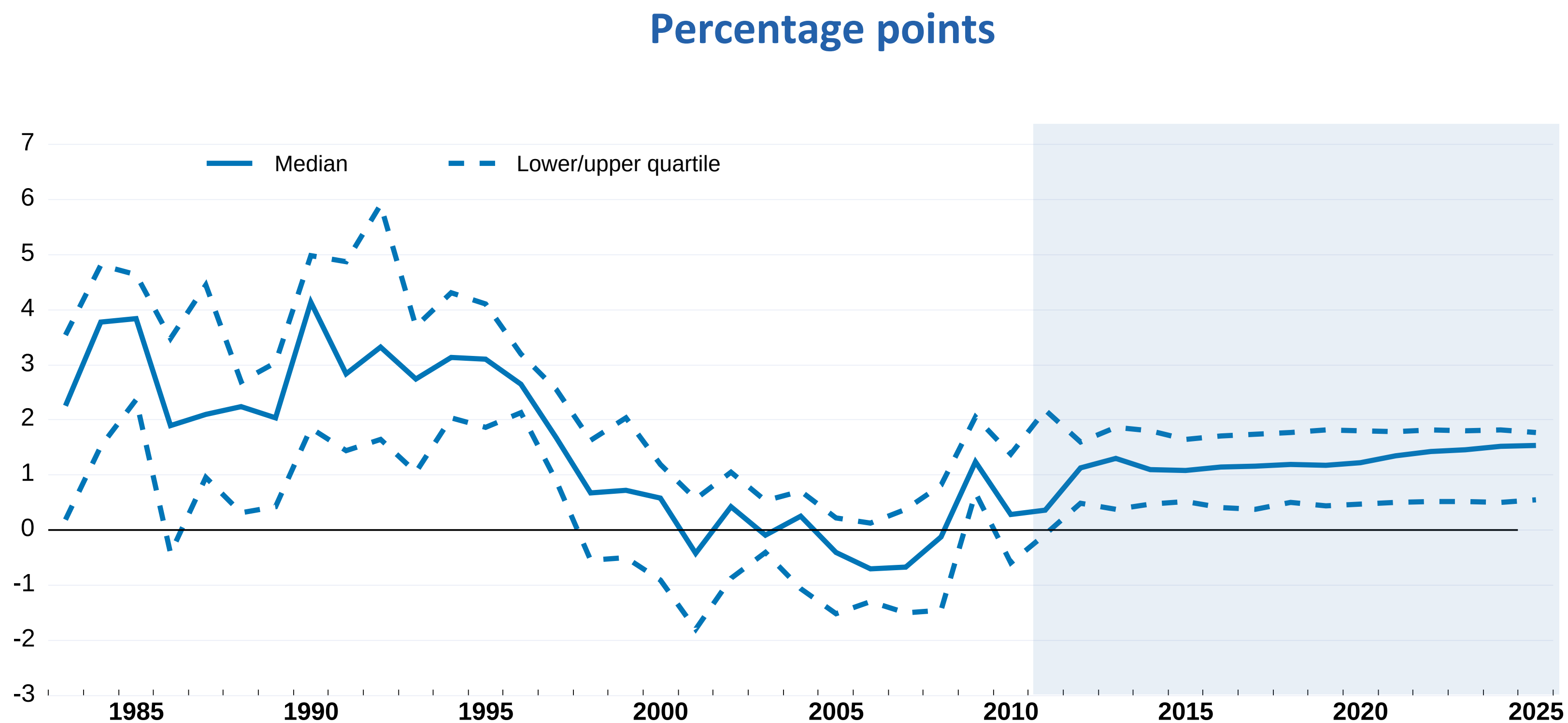
Improvement in underlying primary balances, percentage points of GDP



Note: Consolidation through 2011 and 2012 as projected in Economic Outlook 89; consolidation after 2012 assumed to be an additional ½ percentage points of GDP each year.
Source: OECD Economic Outlook 89 database; and OECD calculations.

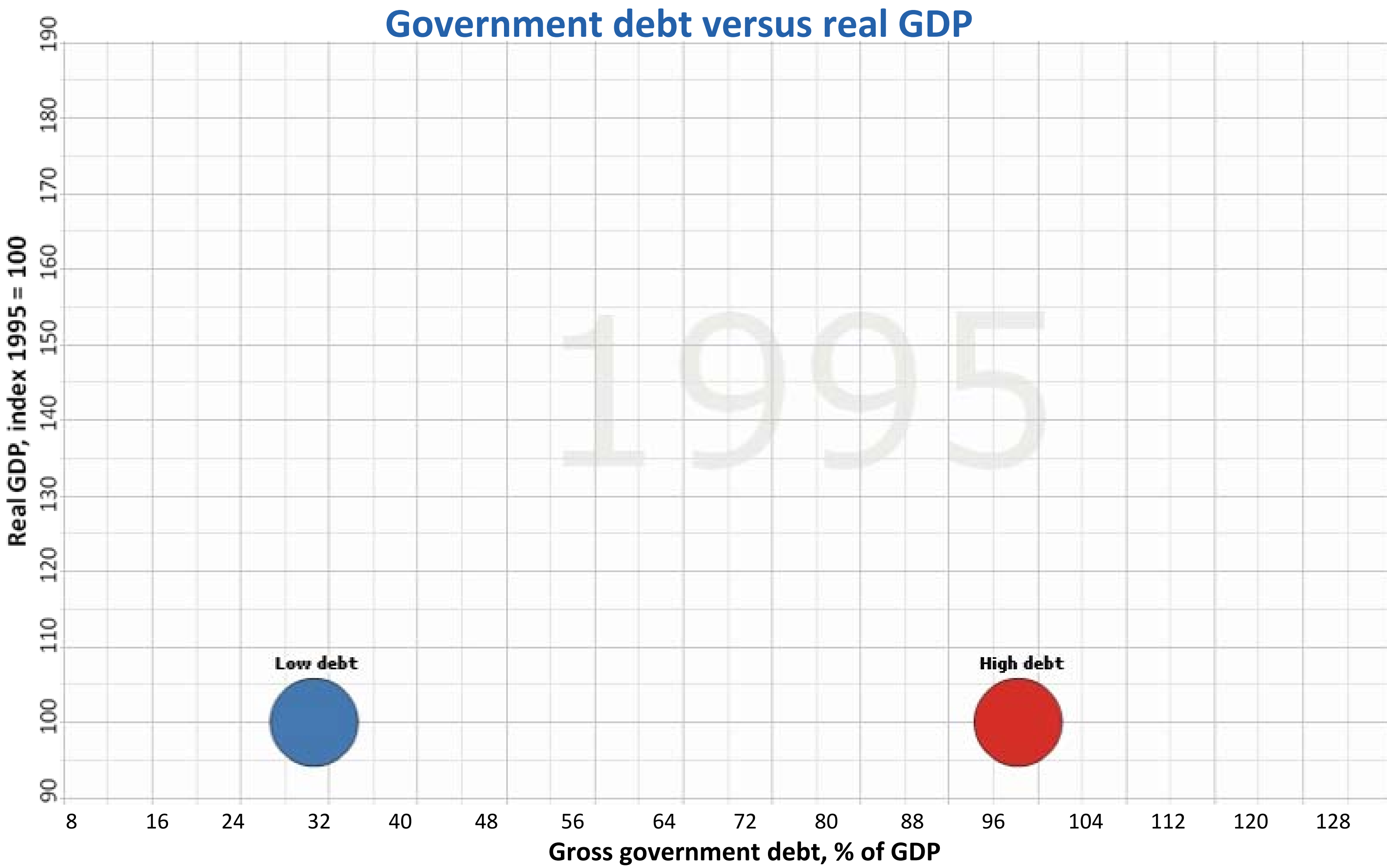
Interest-growth rate differential: unusually favourable prior to the crisis

Comments on Auerbach



Note: 20 OECD countries chosen on the basis of having consistent time series estimates for potential output and long-term interest rates on 10-year government bonds from 1983.
Source: OECD calculations.

Highly indebted countries have tended to grow more slowly



Note: Low debt (debt below 60 % of GDP for the period 1995-2012): AUS, CHE, CZE, EST, KOR, LUX, NOR, NZL, SVK, SVN; high debt (debt above 60 % of GDP for the period 1995-2012): AUT, BEL, CAN, FRA, GRC, ISR, ITA, JPN, PRT.
Source: OECD Economic Outlook 89 database; and OECD calculations.

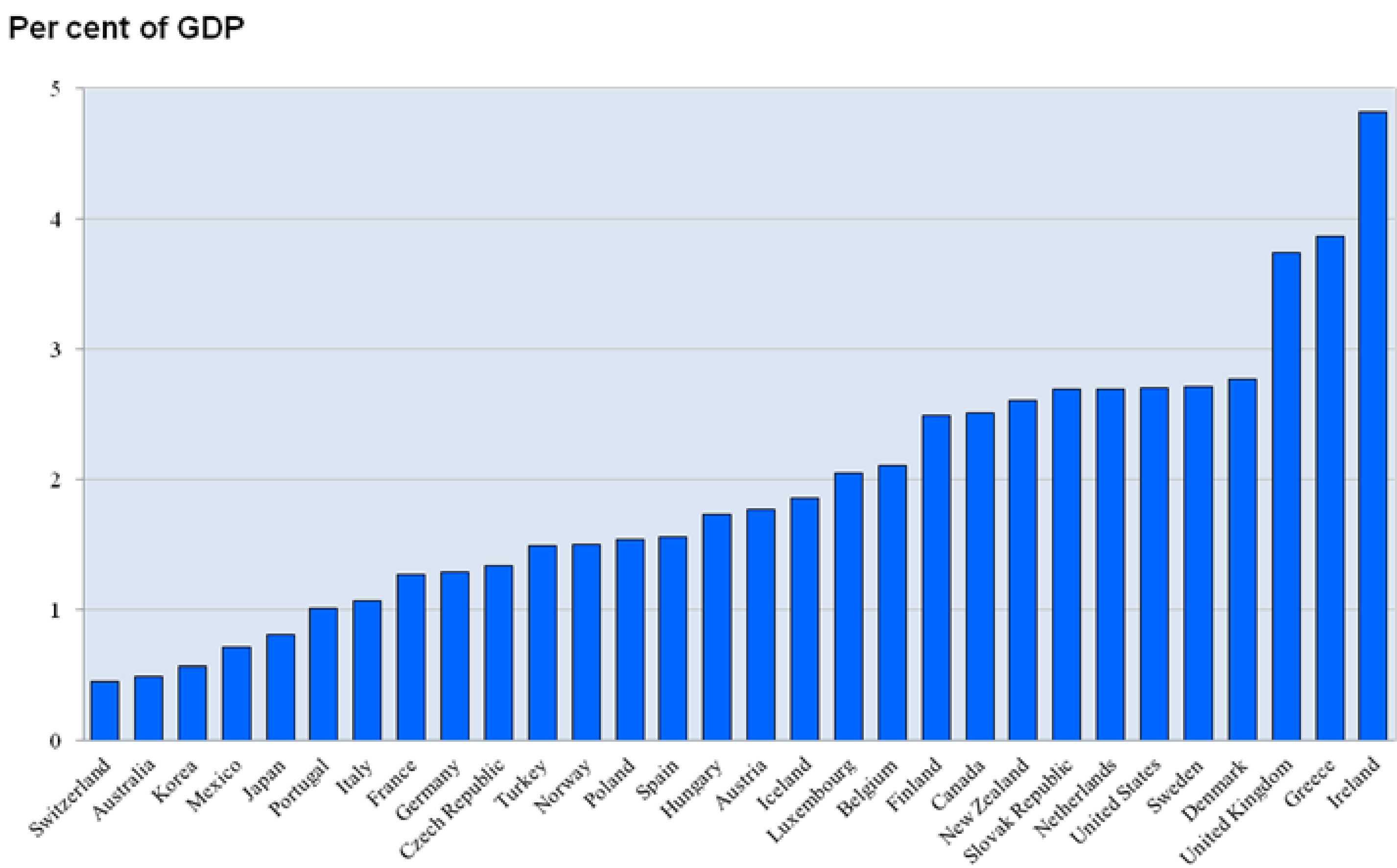
Growth friendly fiscal consolidation

- Productivity enhancing consolidation: improve public spending efficiency (health care, education), reduce state control, cut public subsidies (agriculture, energy, housing), tax negative externalities, reduce tax expenditures.

- Employment enhancing consolidation: Reconsider schemes undermining work incentives (better monitor disability and sickness benefits, reduce unemployment benefit levels/duration, phase out early retirement and/or increase retirement age).

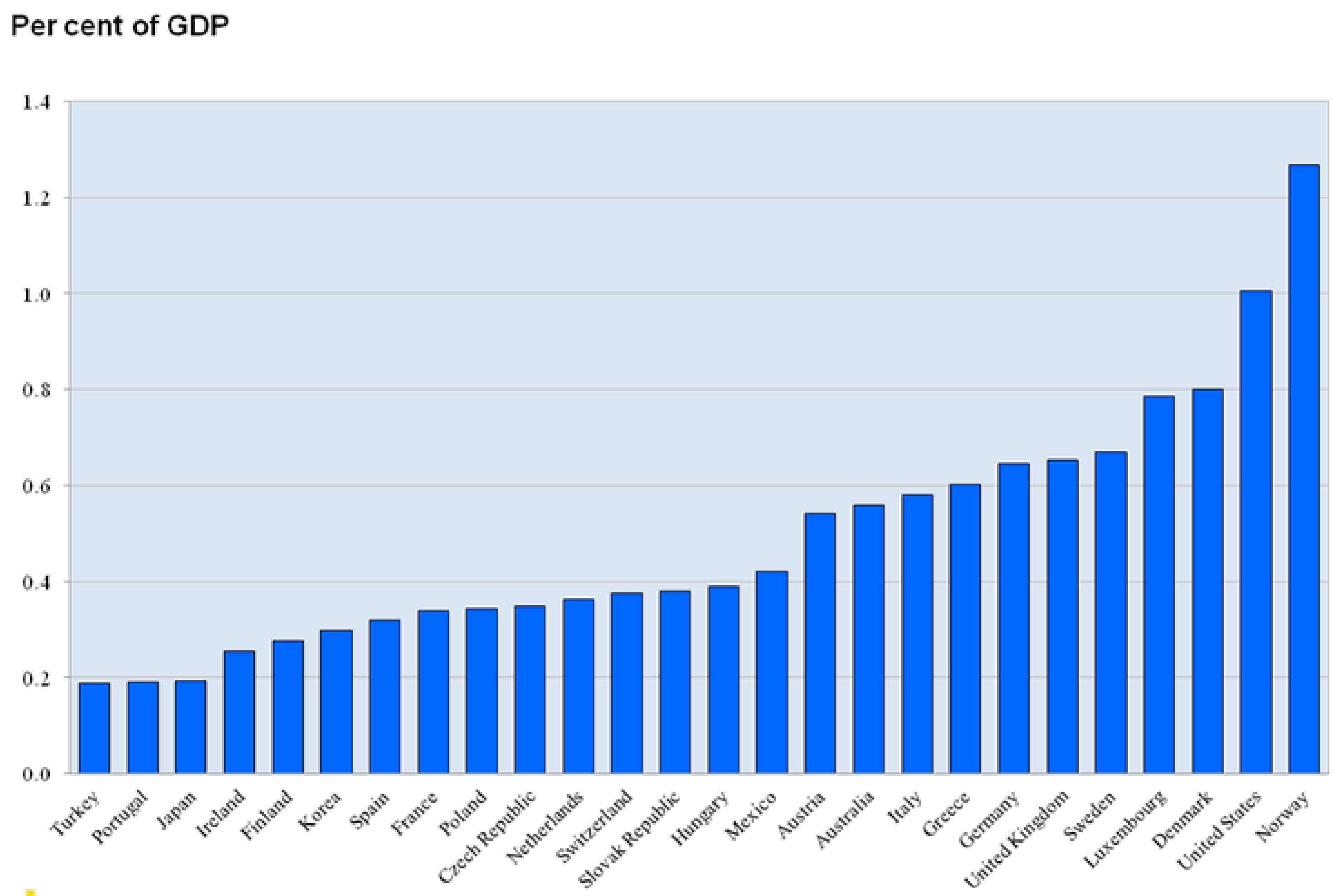
Growth friendly fiscal consolidation: efficiency improvements in health care

Comments on Auerbach



Source: See Chapter 6; OECD estimates based on Joumard *et al.* (2008), "Health Status Determinants: Lifestyle, Environment, Health Care Resources and Efficiency", *OECD Economics Department Working Papers,* No 627.

Growth-friendly consolidation: potential efficiency gains in primary and secondary education



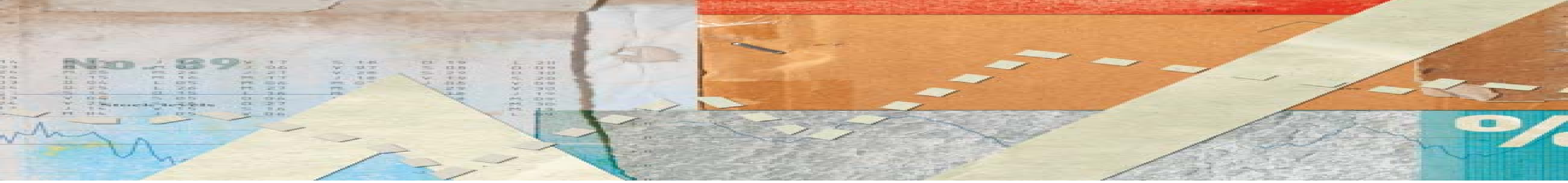
Source: OECD calculations; OECD (2005), *Education at a glance, OECD indicators 2005*.

Tax-based consolidation and growth

- Pricing pollution: Green taxes or auctioning of emission permits offer cost effective solutions while reducing fiscal deficits.

- Cutting tax expenditures: Cuts in tax expenditures, which reach up to close to 20% of total tax revenues in Italy and the United States and 30% in the United Kingdom, reduce economic distortions.

- Fighting tax evasion: Improving tax administrations in tax collection and the fight against tax evasion enhance both tax efficiency and revenues.



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