Available online at www.sciencedirect.com

ScienceDirect

Journal of Policy Modeling 36 (2014) 785–799

Journal of Policy Modeling

www.elsevier.com/locate/jpm

Fiscal consolidation in the euro area: How much pain can structural reforms ease?

Derek Anderson [a,1], Benjamin Hunt [b,2], Stephen Snudden [c,*]

[a] *Department of Economics, University of Virginia, 237 Monroe Hall, Charlottesville, VA 22904-4182, United States*
[b] *Research Department, International Monetary Fund, 700 19th Street, N.W., Washington, DC 20431, United States*
[c] *Department of Economics, Queen's University Kingston, Ontario, Canada K7L 3N6*

Received 21 April 2014; received in revised form 12 July 2014; accepted 12 August 2014
Available online 3 September 2014

Abstract

The IMF's Global Integrated Monetary and Fiscal model (GIMF) is used to examine the scope for structural reforms in the euro area to offset the negative impact of fiscal consolidation required to put public debt back on a sustainable path. The results suggest that structural reforms in core countries could be expected to offset the near-term negative impact on activity arising from the required fiscal consolidation. However, for the periphery, the results suggest that it would take several years before structural reforms could return the level of output back to its pre-consolidation path.
© 2014 The Authors. Published by Elsevier Inc. on behalf of Society for Policy Modeling. This is an open access article under the CC BY-NC-SA license (http://creativecommons.org/licenses/by-nc-sa/3.0/).

JEL classification: E24; E27; E62; F41; F42; O43

Keywords: Fiscal consolidation; Fiscal policy; General equilibrium models; Structural reforms

1. Introduction

Several euro area countries must implement substantial fiscal consolidation to put public finances back on a sustainable path. Although this required consolidation will improve

* Corresponding author. Tel.: +1 613 532 2360.
E-mail addresses: dta7dk@virginia.edu (D. Anderson), bhunt@imf.org (B. Hunt), snudden@econ.queensu.ca (S. Snudden).
[1] Tel.: +1 434 924 3177.
[2] Tel.: +1 202 623 6361.

http://dx.doi.org/10.1016/j.jpolmod.2014.08.005
0161-8938/© 2014 The Authors. Published by Elsevier Inc. on behalf of Society for Policy Modeling. This is an open access article under the CC BY-NC-SA license (http://creativecommons.org/licenses/by-nc-sa/3.0/).

long-run output prospects, it will likely slow activity in the short run. Simultaneously implementing structural reforms to raise growth could be one way to help mitigate the short-run negative impact on GDP. We use the International Monetary Fund's (IMF) Global Integrated Monetary and Fiscal Model (GIMF) to provide estimates of the impact structural reforms may have on softening the near-term contractionary effects of euro area fiscal consolidation.

For the analysis, the euro area is divided into two regions, one with acute fiscal sustainability issues, referred to as the periphery, and one with less acute sustainability issues, referred to as the core.[3] The magnitudes and the timing of the required consolidation are stylized but loosely based on the consolidations contained in the April 2013 *World Economic Outlook* (WEO). We assume that periphery countries must improve structural fiscal balances by roughly 4 percent of GDP over the 2013–2018 period, with core countries improving by roughly 2 percent of GDP. Using a plausible composition of instruments we find that the level of real GDP in 2018 would be lower than the pre-consolidation path by 1.2 percent in the periphery and 0.6 percent in the core.

Using OECD estimates of the impact of a range of structural reforms on productivity and employment in euro area countries, simulations suggest that structural reforms could completely offset the negative implications of consolidation in the core and lead to a sizable cumulative net gain in output over the 2014–2018 period. For periphery countries, the estimates suggest that it will take several years before structural reforms would offset the negative implications of the required consolidation on activity. Further, the only way that there would be net cumulative gain in output by 2018 for the periphery is if sizable structural reforms were implemented.

Looking beyond 2018, the estimates suggest that structural reforms could contribute substantially to raising the level of real GDP in both the euro area core and periphery. For the core, the estimates suggest that after 10 years, real GDP could be higher by between 3 and 8 percent. This increase is even after accounting for the impact of the permanent changes in spending and taxes that would be required under the more plausible consolidation package. Since the periphery is much further from best practices, the potential gains are even larger, between 4½ and 11 percent after ten years. These gains occur despite the fact that the magnitude of the consolidation in the periphery implies cuts in spending and increases in taxes that are double those required in the core.

The remainder of the paper is structured as follows. Section 2 provides a brief overview of GIMF. Section 3 contains the GIMF estimates of the impact on activity of a range of fiscal plans that achieve the desired improvement in structural fiscal balances in the euro area. Section 4 presents a detailed analysis of the impact on activity of the range of structural reforms recommended by the OECD in their Going for Growth initiative. Section 5 considers the fiscal consolidations and structural reforms simultaneously and Section 6 concludes.

2. The Global Integrated Monetary and Fiscal Model

GIMF is a multicountry Dynamic Stochastic General Equilibrium (DSGE) model with optimizing behavior by households and firms and full intertemporal stock-flow accounting. Frictions

[3] Those countries with acute fiscal sustainability issues (called periphery) include Greece, Ireland, Italy, Portugal, and Spain, while the remaining euro area countries are included in the region with less acute sustainability issues (called the core).

Download English Version:

https://daneshyari.com/en/article/10478798

Download Persian Version:

https://daneshyari.com/article/10478798

Daneshyari.com