

F A D

Ambrogio Lorenzetti; The Effects of Good Government on the City Life; Fresco; Palazzo Pubblico, Siena (Italy)

Fiscal Policy and the Global Crisis

Presentation at Koç University, Istanbul

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June 9, 2009

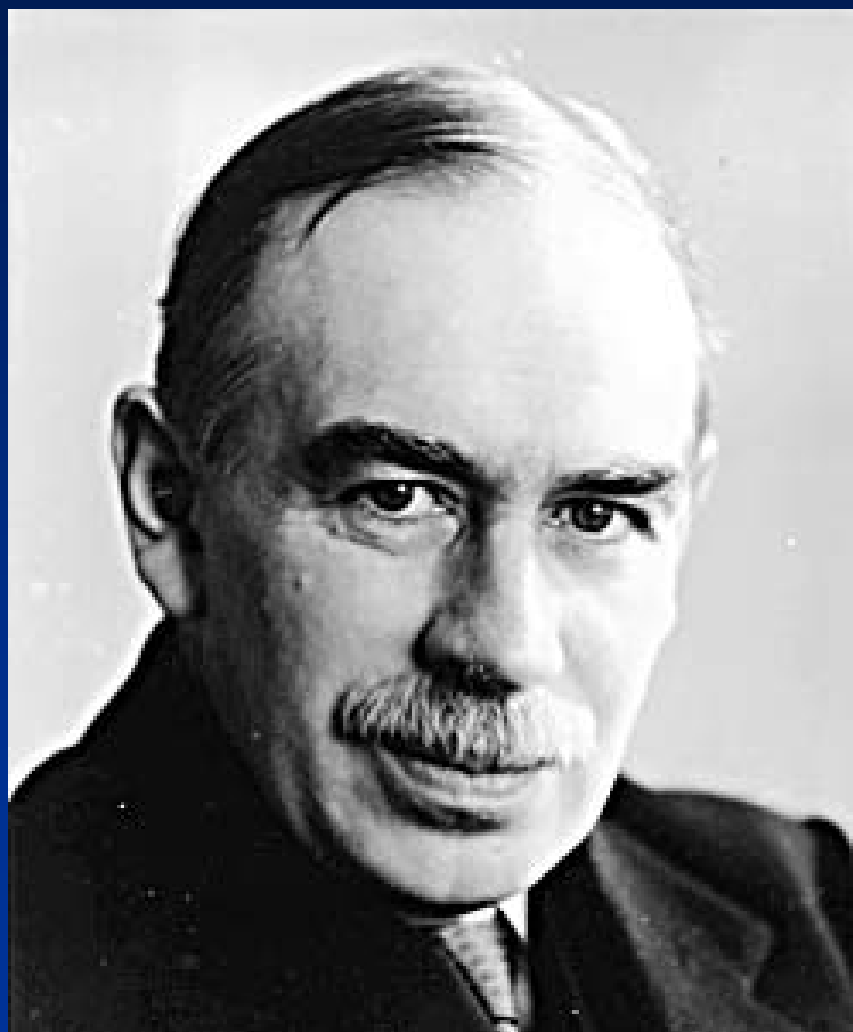


Two fiscal questions

- What is the appropriate fiscal policy in the short term....and what does this imply for the fiscal outlook?
- What are the key elements of a fiscal strategy to ensure fiscal solvency?



John Maynard Keynes



Charles Ponzi





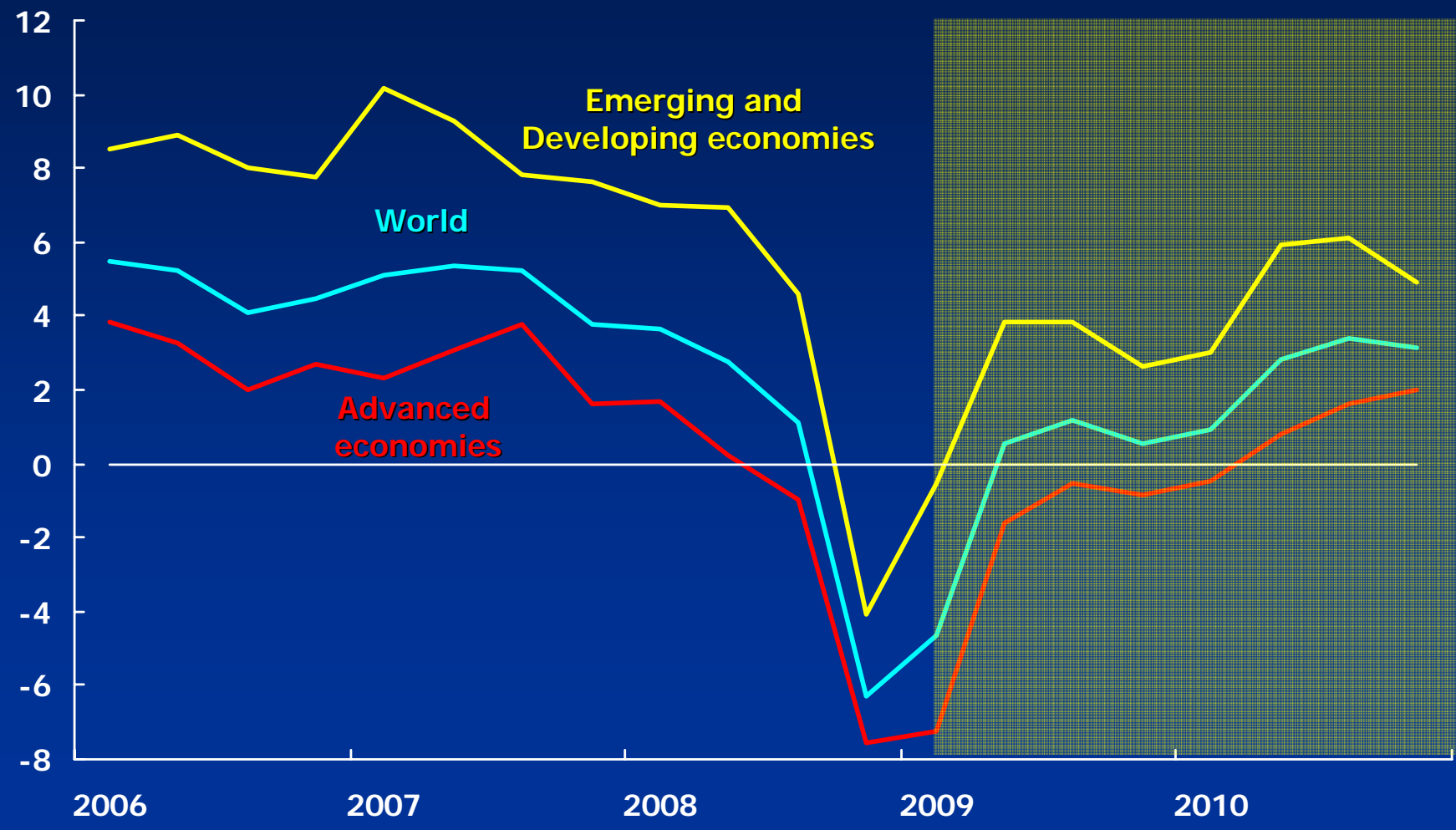
Here is the Challenge

- To allow fiscal policy to support the economy
- While reassuring markets that this is not a Ponzi scheme



Growth Projections

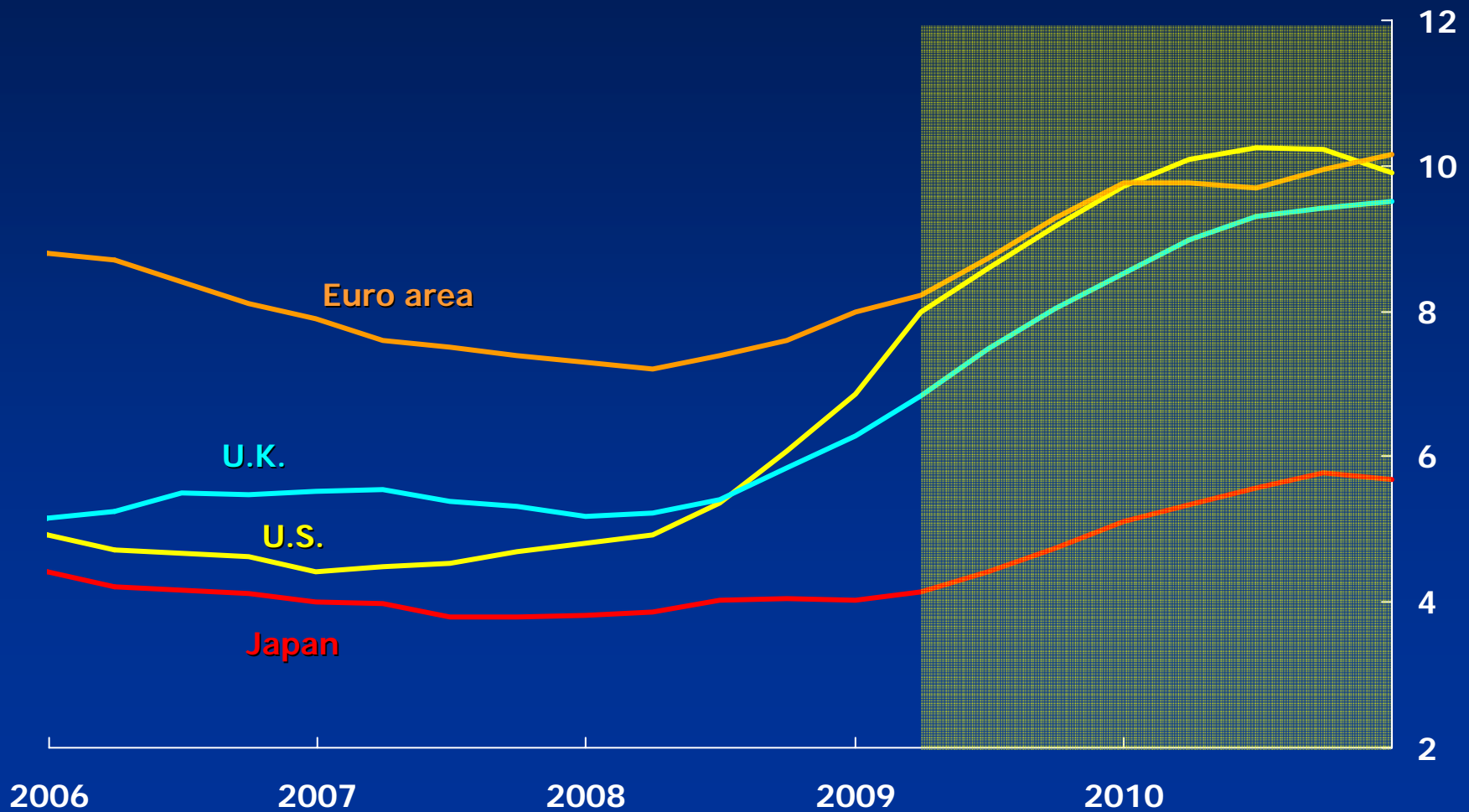
Real GDP Growth
(in percent; QoQ; saar)



Unemployment Rate Projections



Unemployment Rate *(in percent)*

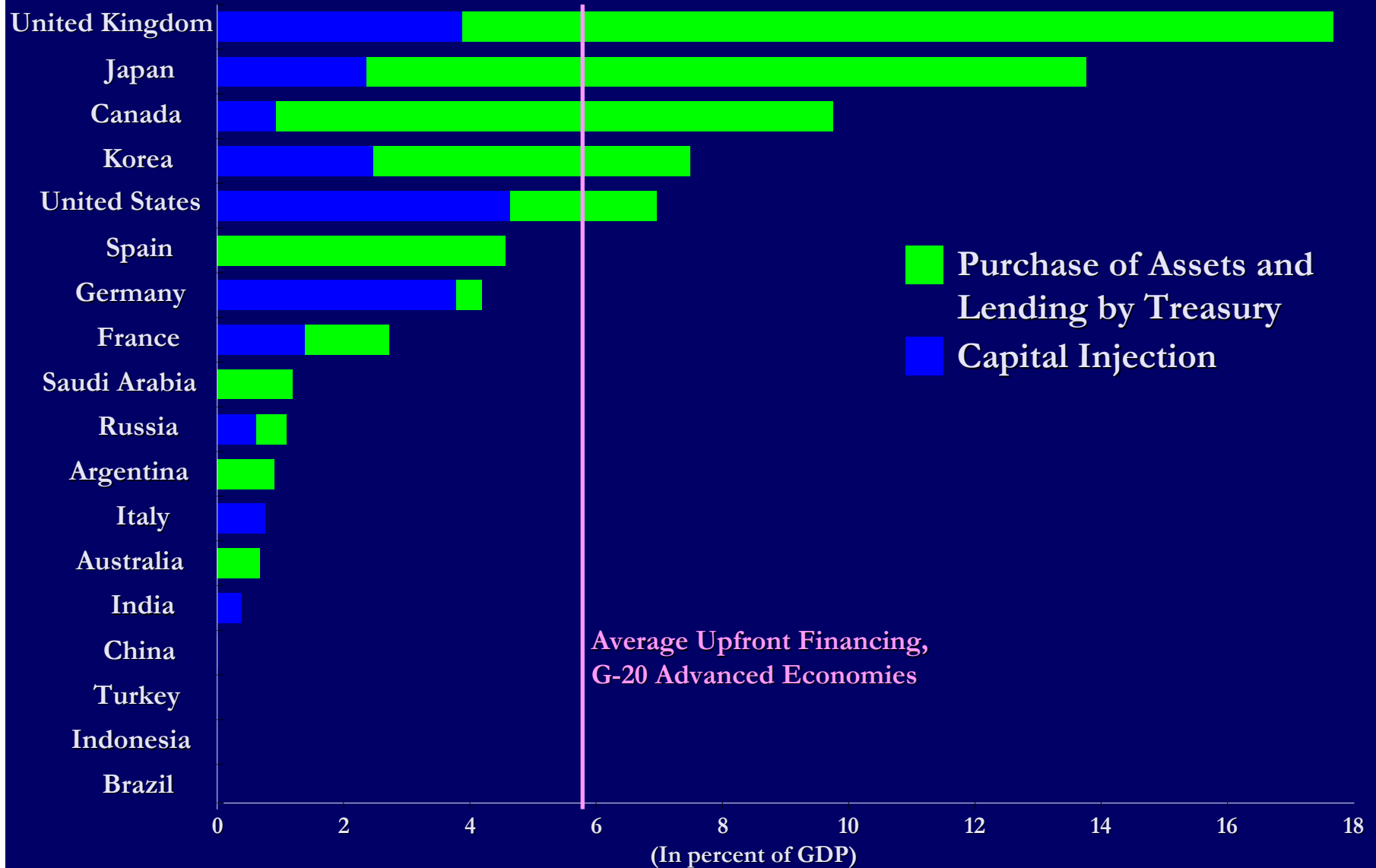




What roles can government play?

- Interventions to address the financial sector problems
- Fiscal policy to support aggregate demand

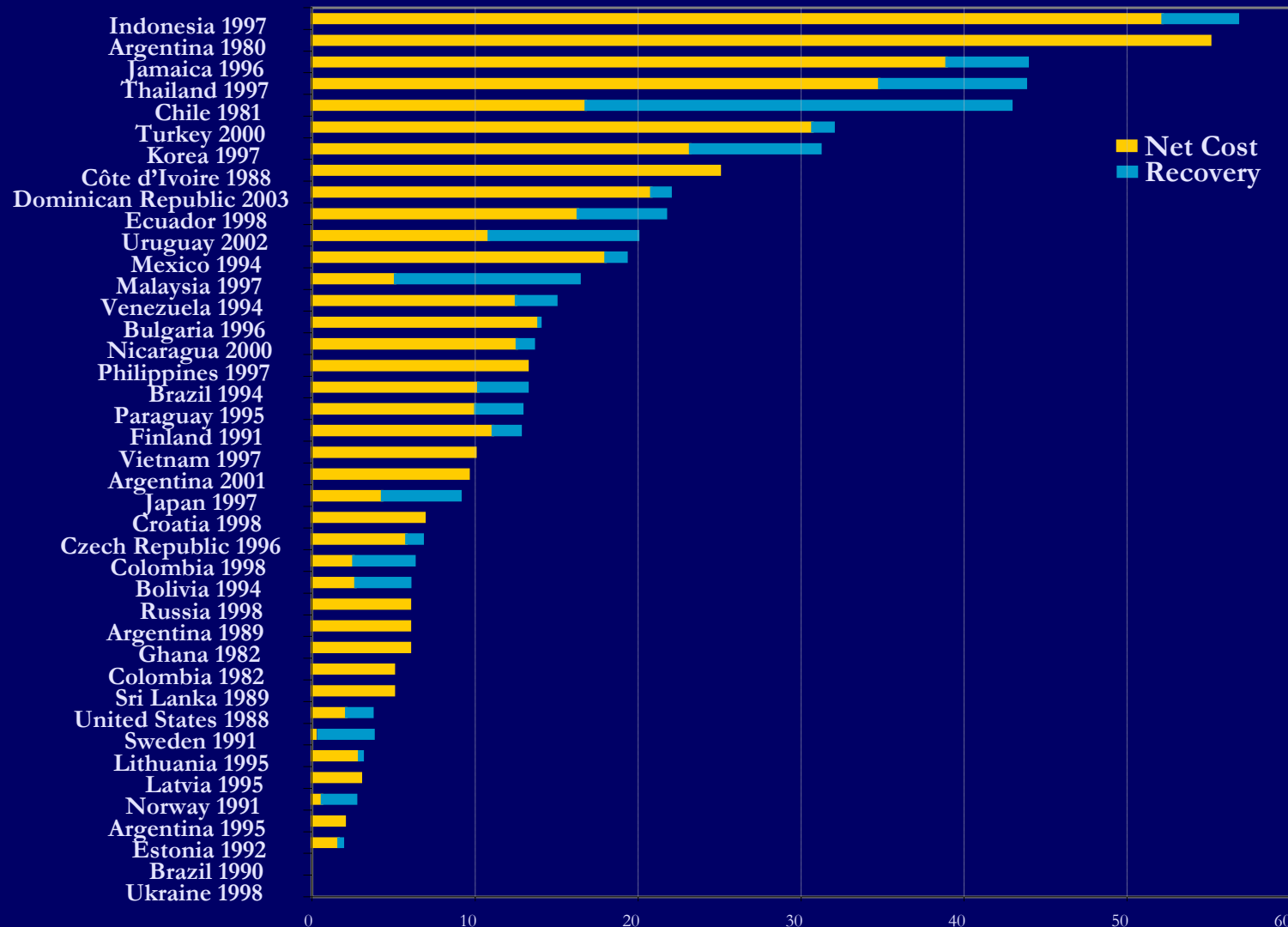
Support Measures with Immediate Effect on Government Debt





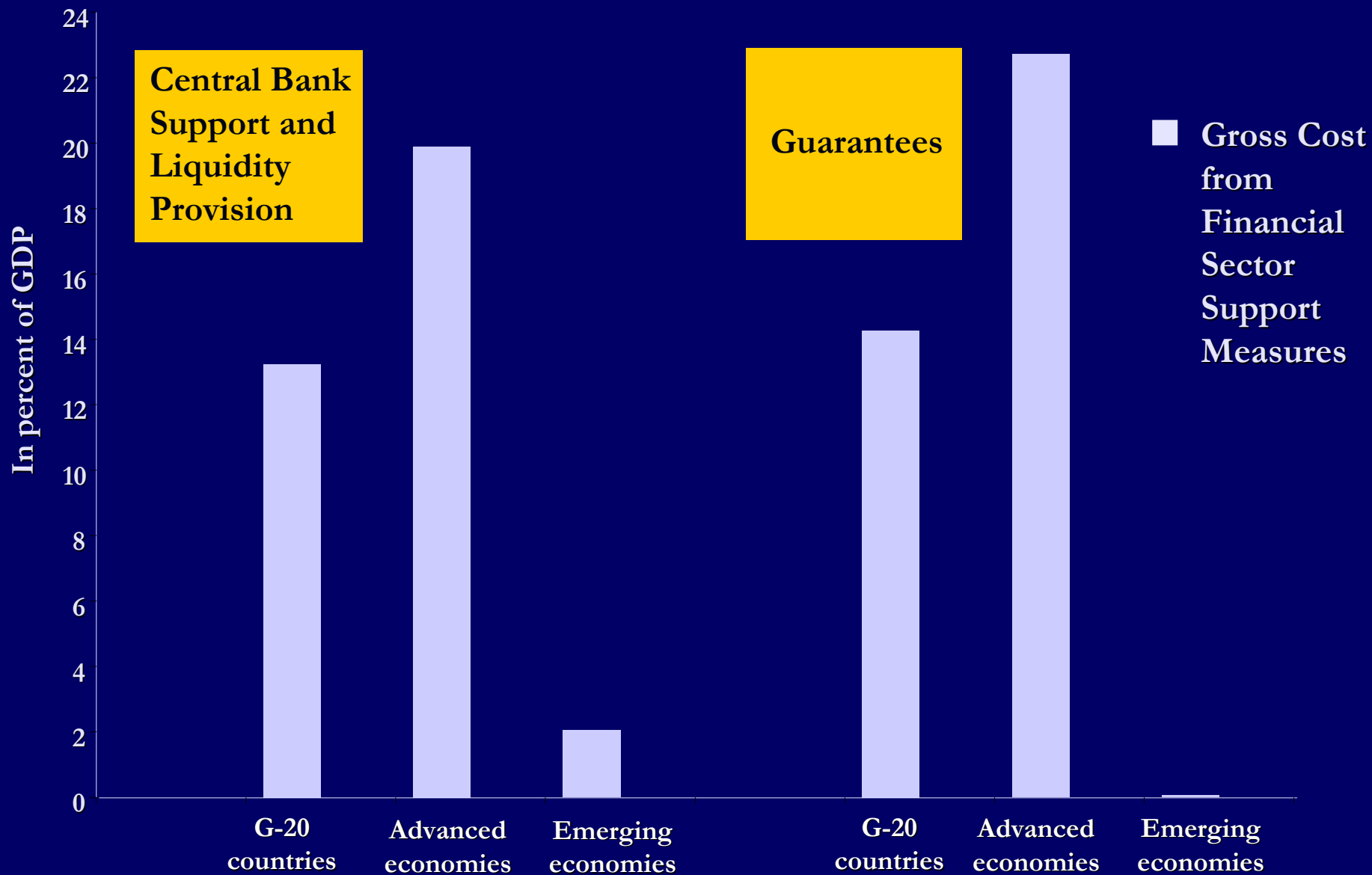
Gross and Net Fiscal Cost of Banking Crises

(in Percent of GDP)



Source: Laeven and Valencia (2008), Japan Deposit Insurance Corporation, Hoelscher and Quintyn (2003), and IMF staff estimates.

Support without Immediate Effect on Government Debt





Fiscal Stimulus

Implementation of fiscal stimulus in advanced and emerging economies that have fiscal space

- Timely
- Large
- Lasting
- Diversified
- Contingent
- Collective
- Sustainable



IMF STAFF POSITION NOTE

December 29, 2008

SPN/08/01

Fiscal Policy for the Crisis

Antonio Spilimbergo, Steve Symansky, Olivier Blanchard,
and Carlo Cottarelli

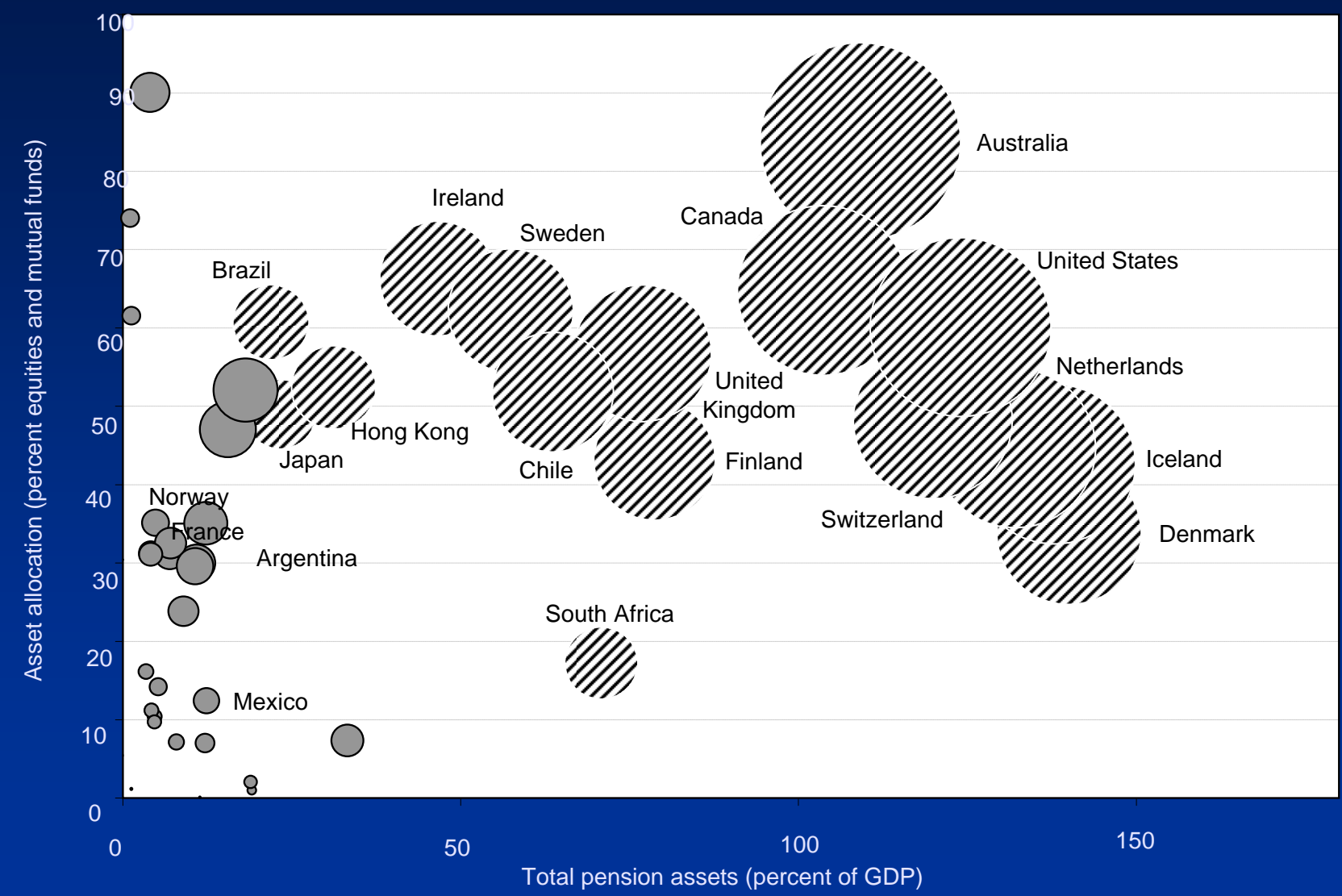
Fiscal Implications Out of the Control of Governments



- Automatic stabilizers
- Strong decline in asset prices and commodity prices
- Crisis impact on funded pension schemes



Pension Plan Assets by Country, End-2007

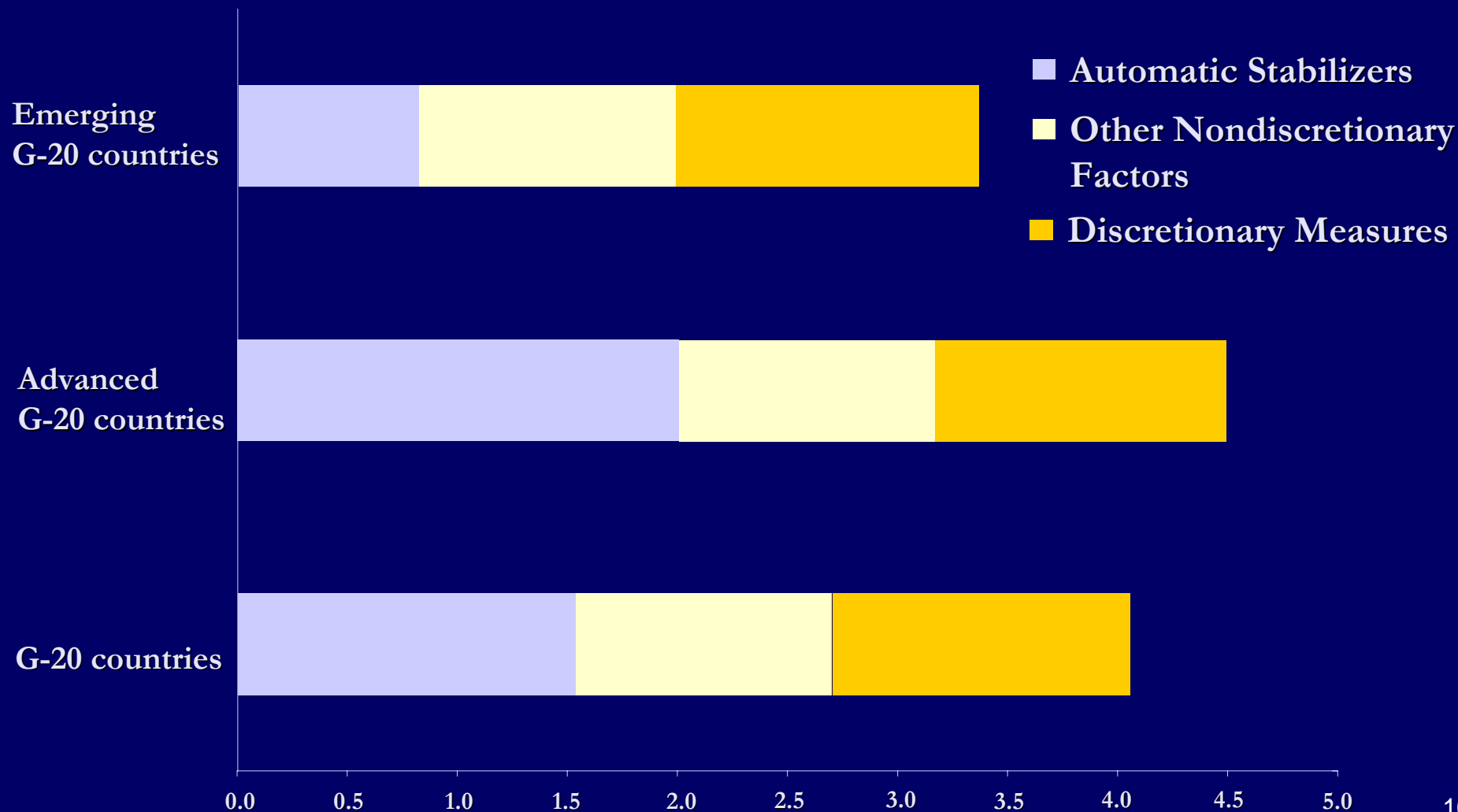


Intervention to Support Aggregate Demand

(2008-2010)



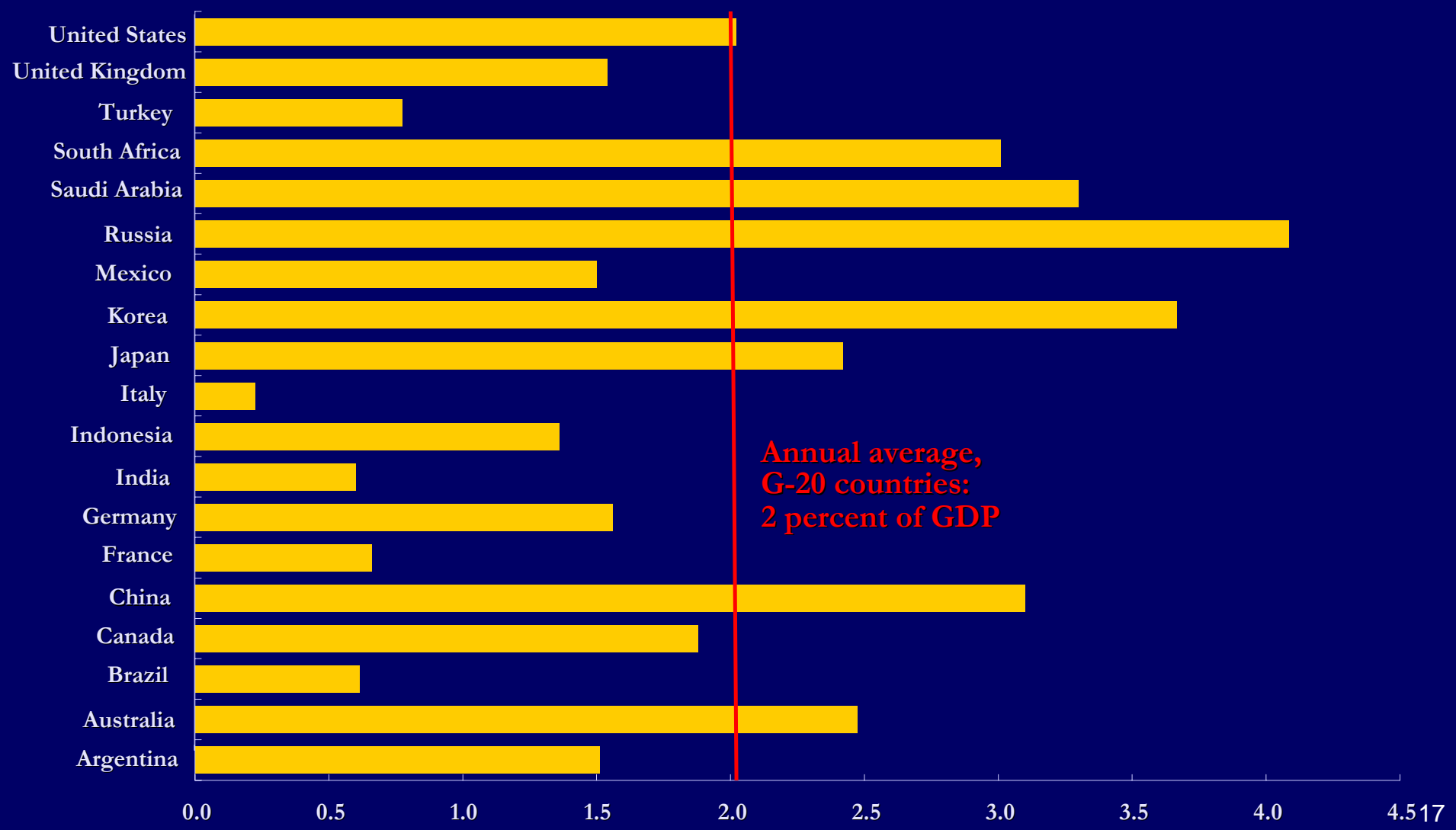
Automatic Stabilizers, Other Nondiscretionary Factors, and Discretionary Measures





Intervention to Support Aggregate Demand

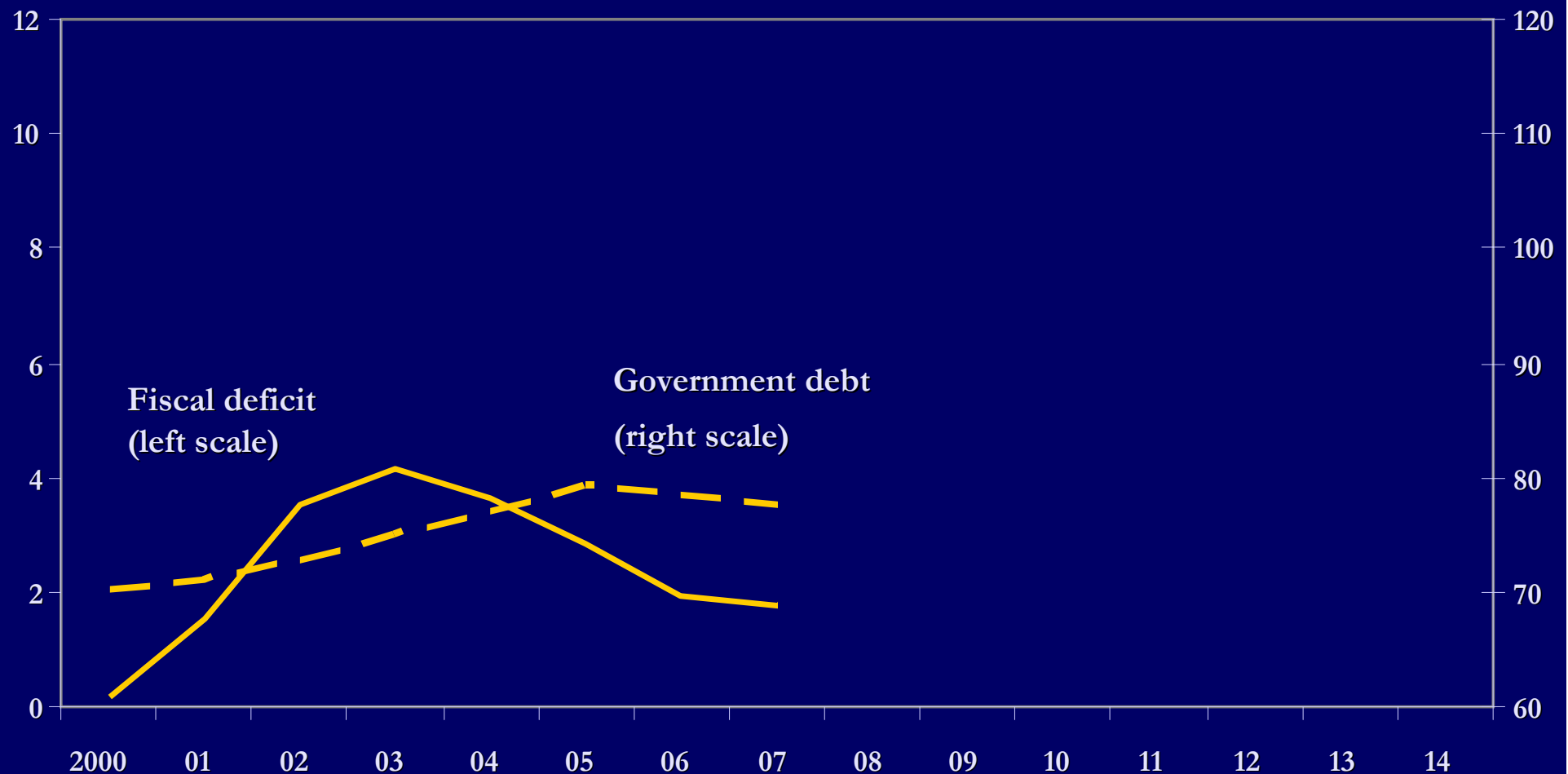
G-20 Countries: Discretionary Measures, 2009



Outlook for Public Finances in Advanced G-20 Countries



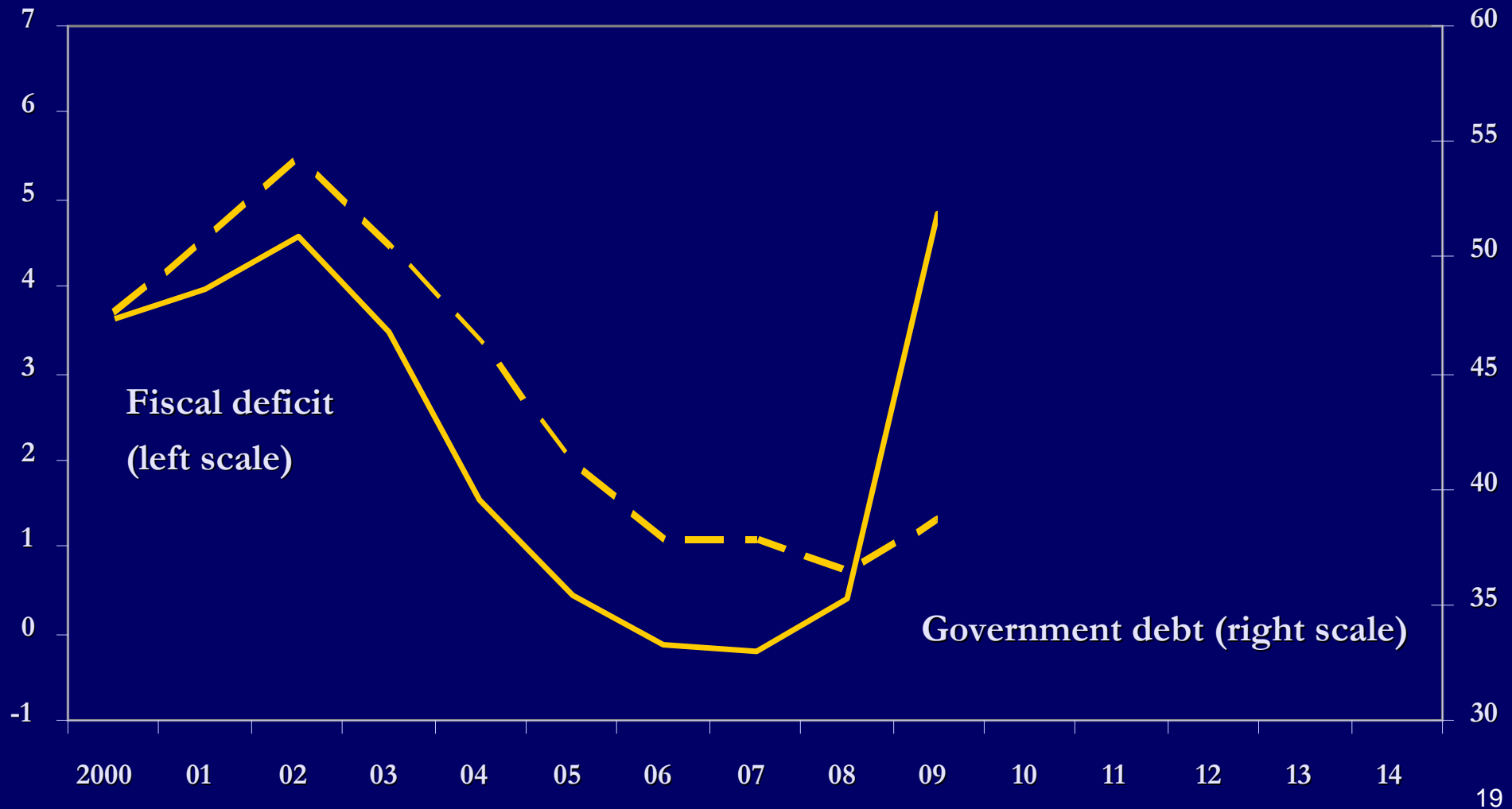
(In percent of GDP)



Outlook for Public Finances in Emerging Market G-20 Countries



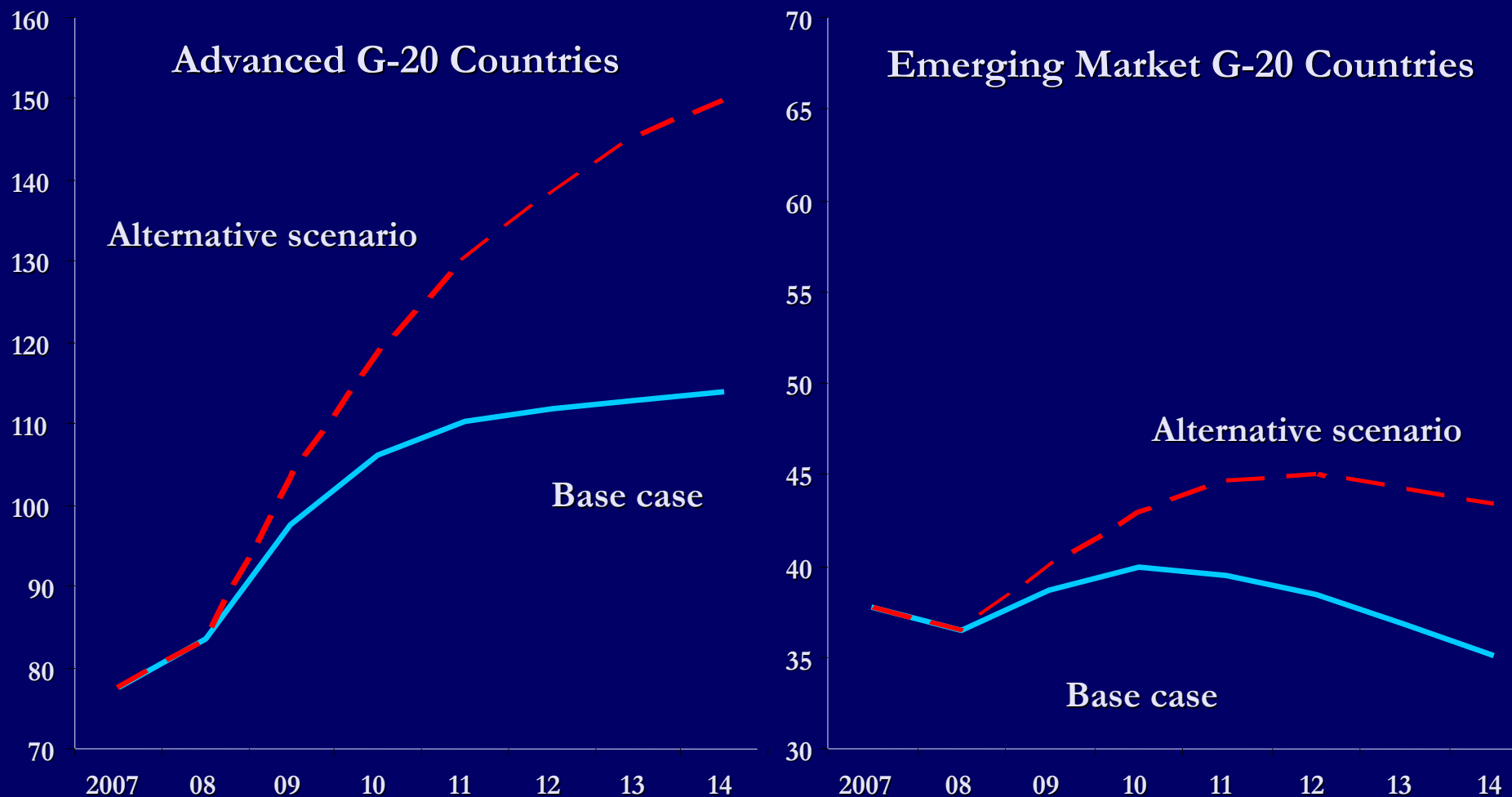
(In percent of GDP)



Prolonged Slowdown/Higher Interest Rate/Contingent Liability Shock



Government Debt (In percent of GDP) 1/



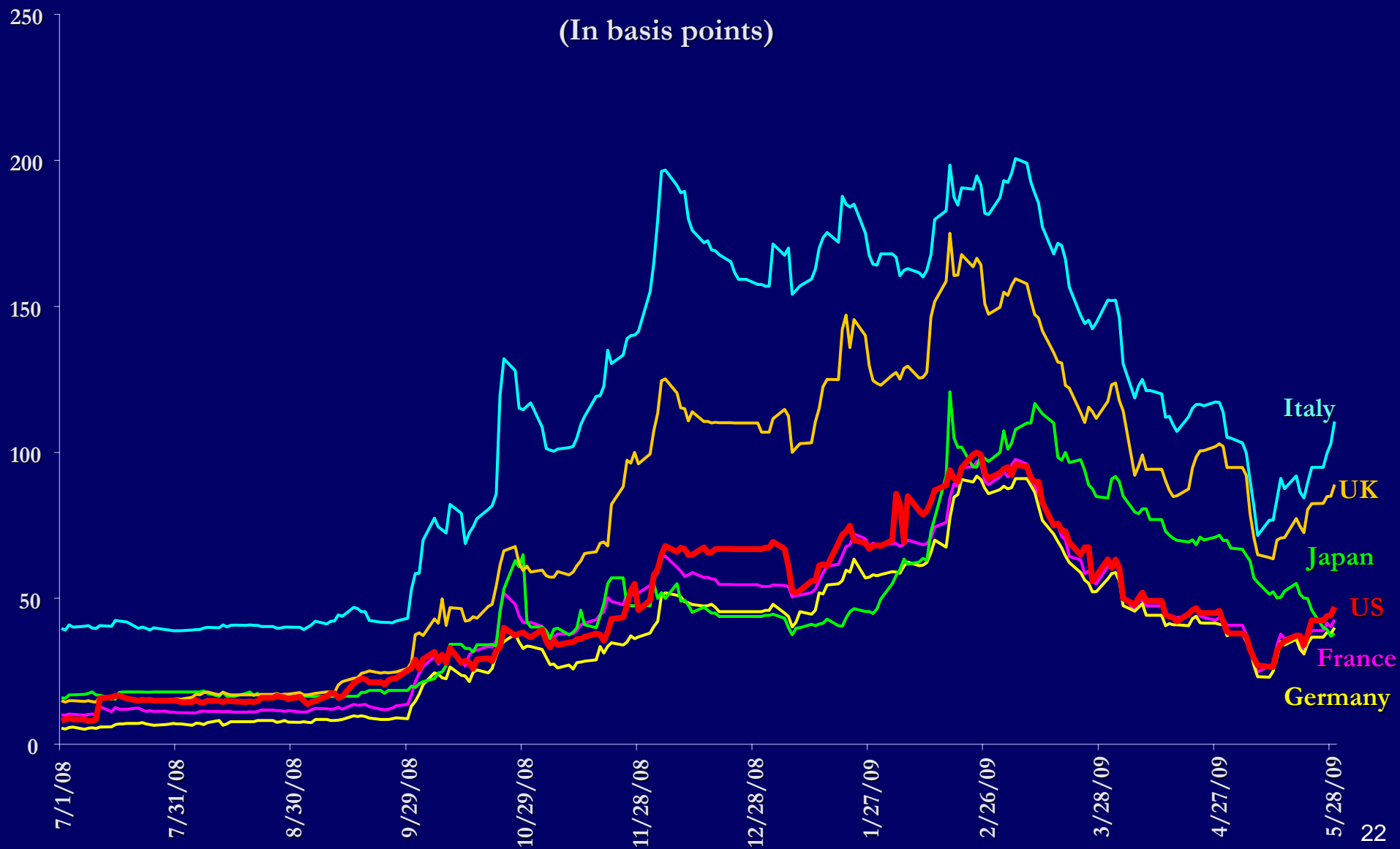
Source: IMF staff estimates.

1/ Figure reports results of a 2 percentage point decline in growth, and a 200 basis point increase in real interest rates relative to the baseline starting in 2009; as well as a contingent liability shock corresponding to expected cost of guarantees (column A in Table A4.1 in Appendix IV). Averages based on PPP GDP weights.



How worried should we be?

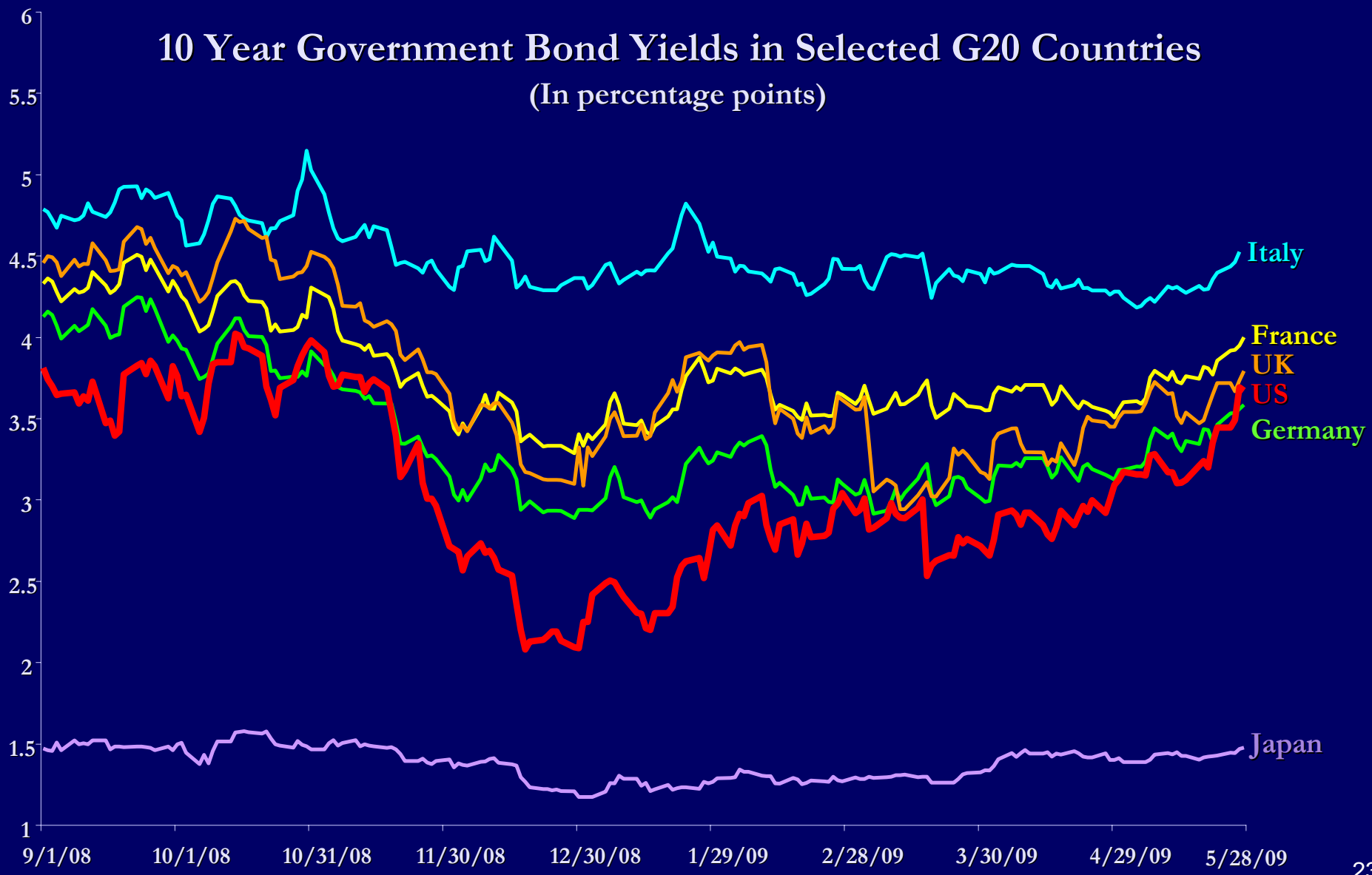
5-year Sovereign Credit Default Swap (CDS) Spreads in Selected Advanced G-20 Countries





Nominal Yields

10 Year Government Bond Yields in Selected G20 Countries (In percentage points)





Fiscal Solvency

- Confidence in governments' solvency has been a source of stability
- Critical to ensure that challenging fiscal outlook does not raise doubts about solvency



What should be done?

INTERNATIONAL MONETARY FUND

**The State of Public Finances:
Outlook and Medium-Term Policies After the 2008 Crisis**

Prepared by the Fiscal Affairs Department

In cooperation with other departments

Approved by Carlo Cottarelli

March 6, 2009



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Four-Pillar Strategy: I



- Fiscal stimulus
 - Temporary measures...
 -but because the decline in private sector demand is likely to be long-lasting, prolonged measures
 - Avoid permanent raise in fiscal deficits



Four-Pillar Strategy: II

- Medium-term fiscal frameworks
 - Fiscal rules
 - Revisions to Budgetary procedures
 - Introduction of fiscal councils
 - Manage and ultimately dispose of financial sector assets acquired

Governments should commit to tighten fiscal policy in future good times, now that fiscal policy has been relaxed during bad ones.



Four-Pillar Strategy: III

■ Structural reforms to enhance growth

Emerging Market Economies: Selected Debt Reduction Episodes (in percent of GDP)

Country/Time period	Initial level of debt	Debt reduction	Contribution to debt reduction			
			Primary surplus	Growth - interest rate differential	Real exchange rate appreciation	Other
Poland (1993-98)	84.3	47.7	3.3	22.6	9.6	12.1
Chile (1990-1998)	45.9	33.0	30.0	11.5	3.9	-12.5
Ecuador (1988-1990)	113.5	32.1	4.1	11.4	-11.8	28.4
Pakistan (2001-07)	84.8	29.7	6.4	17.1	5.1	1.0
Egypt (2003-07)	114.9	27.7	-11.0	29.9	1.9	6.8
Jamaica (2002-07)	122.0	27.4	50.8	-30.3	3.8	3.2
Brazil (2002-05)	85.0	20.8	12.4	1.7	4.6	2.1
Colombia (2002-07)	49.8	16.4	14.4	1.0	4.6	-3.6
Malaysia (2003-07)	44.4	14.5	-4.3	8.3	2.4	8.1
Tunisia (2001-07)	62.7	11.8	-0.7	8.1	6.4	-2.0
Average (unweighted)	80.7	26.1	10.6	8.1	3.0	4.4

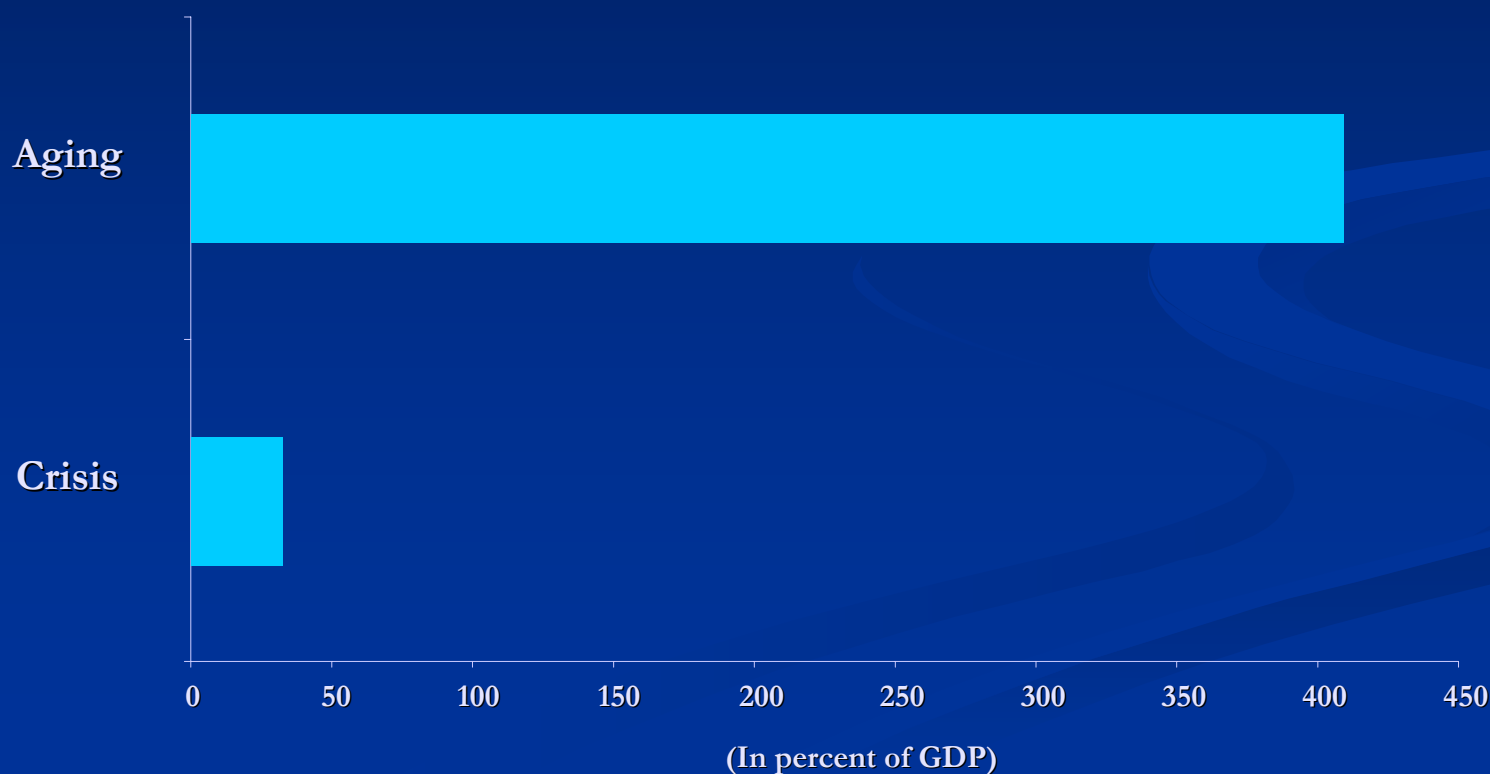
Sources: IMF, World Economic Outlook; and IMF staff estimates



Four-Pillar Strategy: IV

- Tackle long-run pressures from population aging

Net Present Value of Impact on Fiscal Deficit of Crisis and Aging-Related Spending





Four-Pillar Strategy: IV

- Tackle long-run pressures from population aging

Net Present Value of Impact on Fiscal Deficit of Crisis and Aging-Related Spending

(In percent of GDP, unless otherwise indicated) 1/, 2/

Country	Crisis	Aging	Crisis/Aging
Australia	28	482	5.8
Canada	18	726	2.5
France	30	276	10.9
Germany	27	280	9.7
Italy	34	169	20.3
Japan	35	158	22.1
Korea	20	683	2.9
Mexico	13	261	4.8
Spain	37	652	5.6
United Kingdom	37	335	11.1
United States	34	495	6.9
Advanced G-20 Countries	32	409	10.1

Source: IMF staff estimates.

1/ Table reports net present value of the impact on fiscal balance of the crisis and of aging-related spending increases reported in Table 6.1. The third column reports the ratio of the first column to the second column in percent. The discount rate used is 1 percent a year in excess of GDP growth for each country. Given that real growth is expected to average 3 percent a year, this is equivalent to applying an average real discount rate of 4 percent a year. For years after 2050, the calculation assumes the impact is the same as in 2050.

2/ Averages based on PPP GDP weights.



Thank you!