

Parallel Session: Potential Growth Discussion

Susanne Maidorn
Office of the Fiscal Advisory Council

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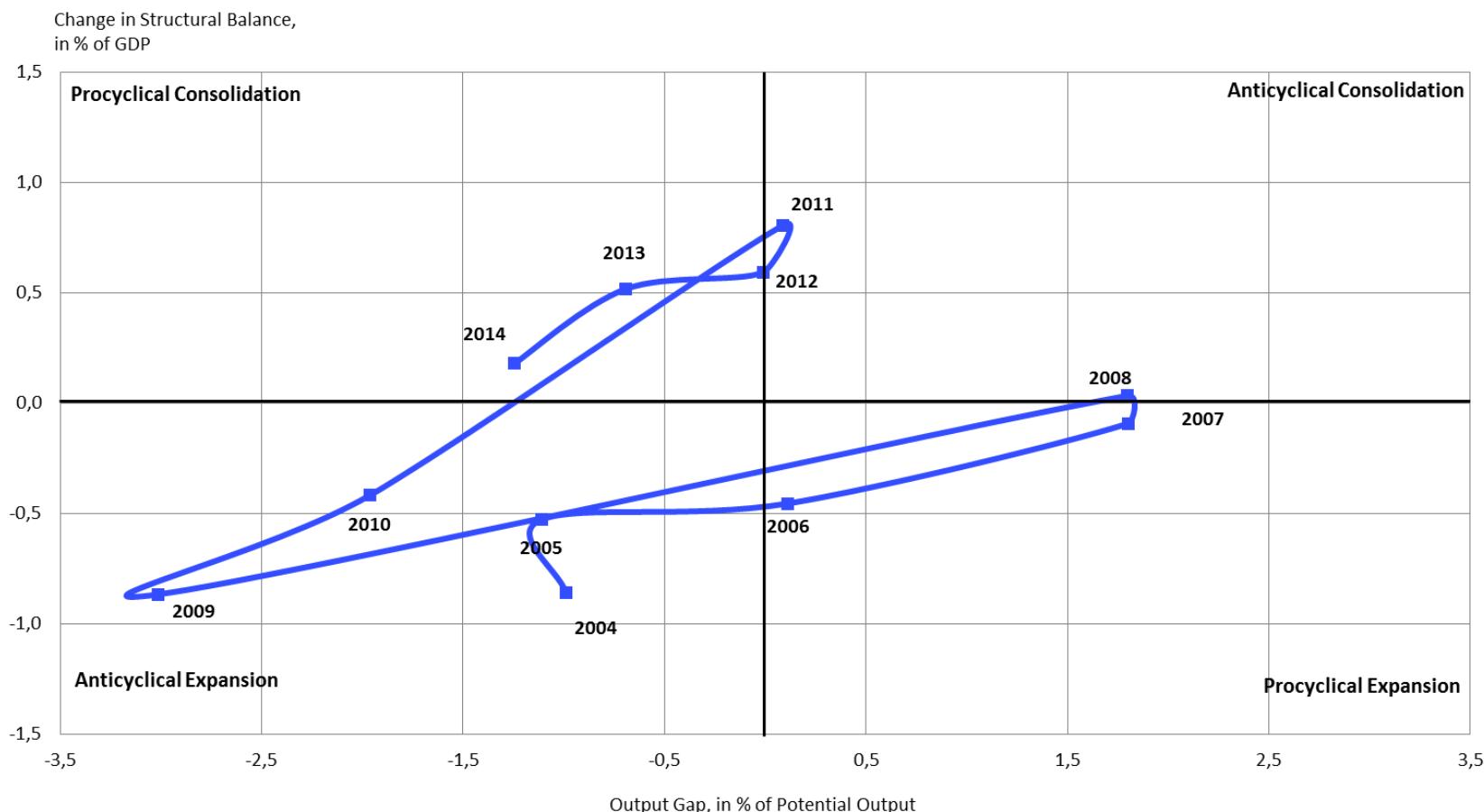
Austrian Fiscal Advisory Council

- Independent Fiscal Institutions (IFI): a compulsory element in the European fiscal governance framework
- Monitor compliance with national/EU fiscal rules
- Assess current fiscal situation including outlook
- Ex-post evaluation of fiscal policy

■ Should We Still Use the Concept of Potential Growth ? (I)

- Deficit limit of 3% of GDP not sufficient for anticyclical fiscal policy
 - Lack of incentive for consolidation in economic good times
 - Information on violation of the 3% limit in economic bad times comes too late
- Cyclical adjustment of deficit on the basis of potential output estimated by the European Commission

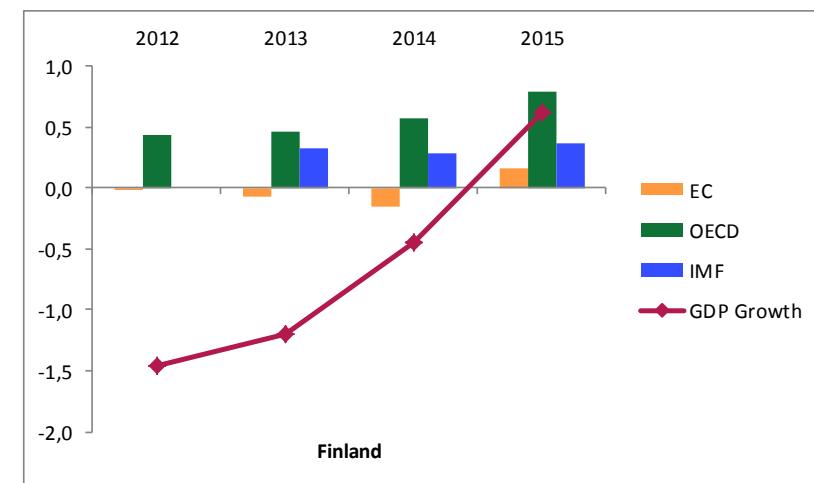
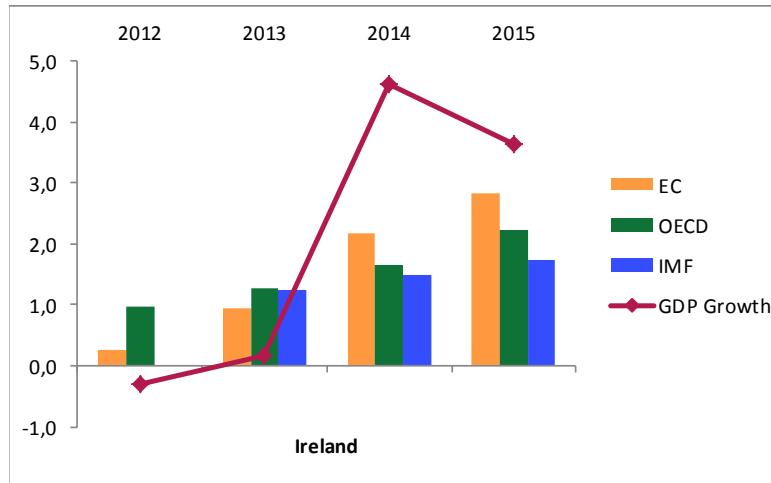
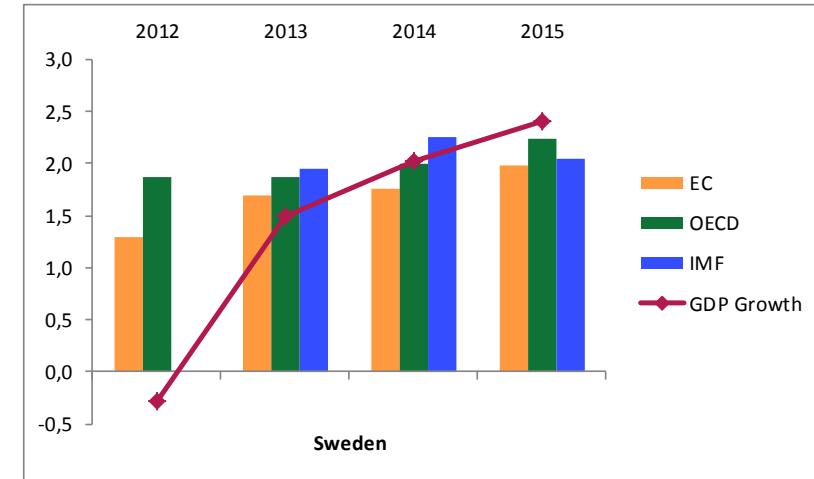
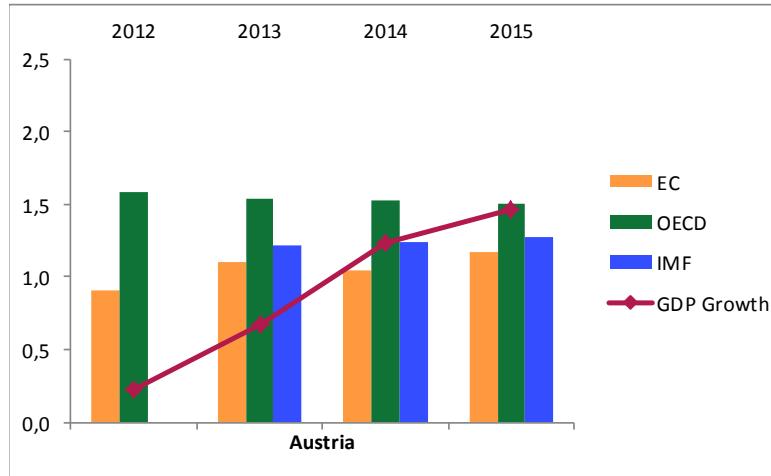
Change in Structural Balance in Austria



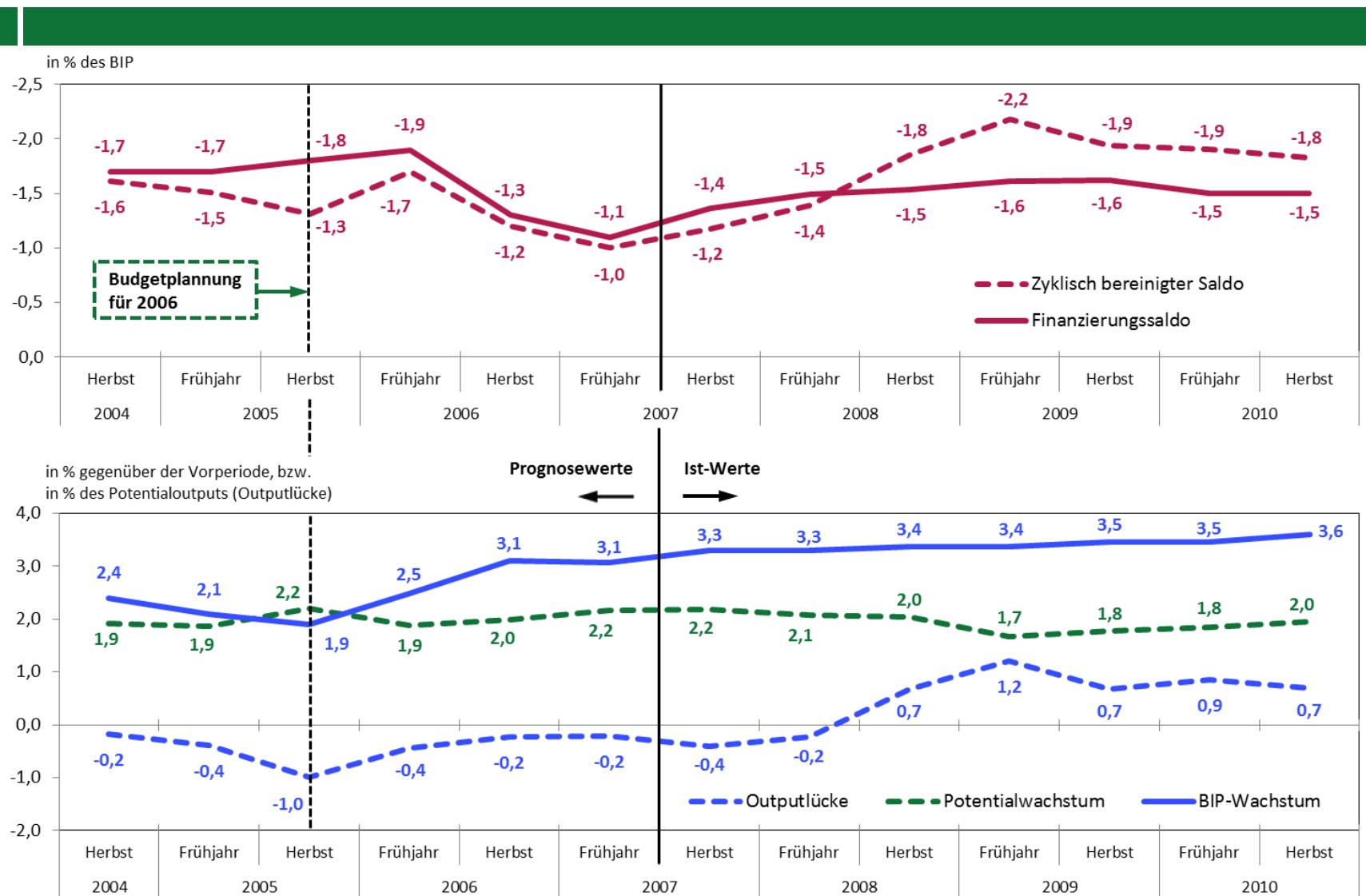
■ Should We Still Use the Concept of Potential Growth ? (II)

- Potential output as estimated by the EC is more procyclical than potential output as estimated by IMF or OECD
 - A higher degree of smoothing of potential output leads to an increase of both, positive and negative gaps between actual output and potential output
 - An increase in output gaps would give more scope for the deficit in economic bad times, and it would be consistent with a stricter judgement of the deficit with regard to the MTO in economic good times
 - A higher degree of smoothing would increase the extent of revisions of the output gap

Potential Growth: EC is more procyclical



Forecasts and Revisions for 2006



■ Europe's Long-Term Growth Prospects: With and Without Structural Reforms

- Declining rates of total factor productivity (TFP) growth
 - Agreement in the literature on lower rate of TFP growth in the future
 - Forecasting the extent of the decline is very difficult
 - Moreover, even years after the crisis, with many economies judged to be operating well below capacity, any assessment can only be preliminary
 - European Comission Spring 2015 Forecast: Average contribution of TFP to potential growth 0.5% in EA 19 in 2017-2019
 - Assumption of medium term trend growth rate of 0.2% in the euro area may be lower bound
 - Decline in potential growth after the crises was dominated by reduction of TFP trend growth in some EA countries

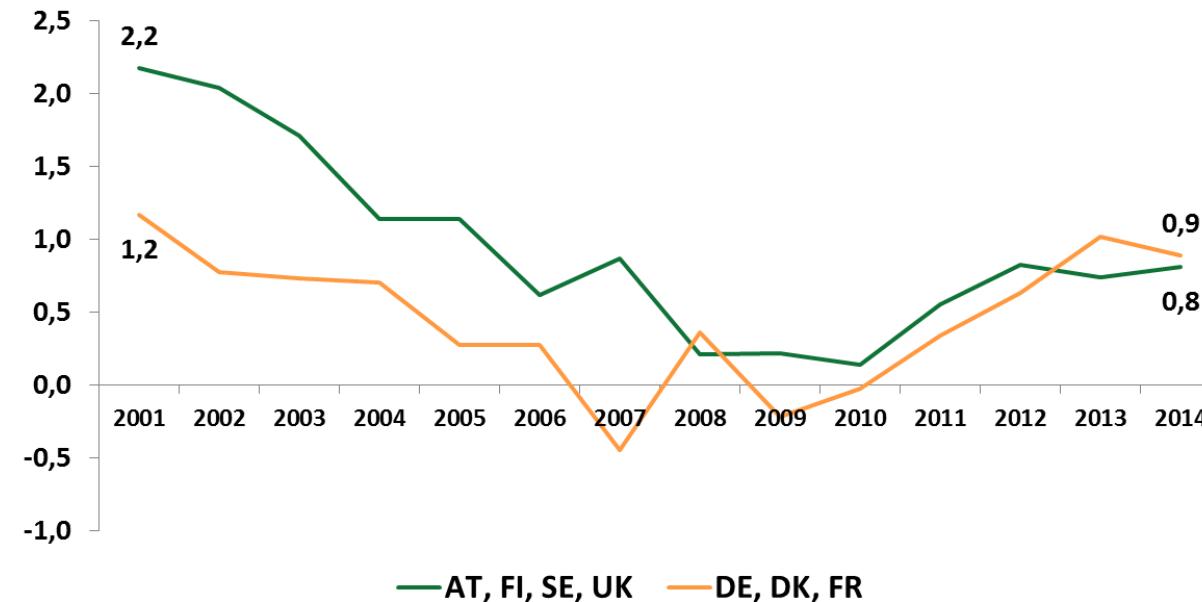
Contribution of TFP to Potential Growth

| | Potential Growth | | Contribution of TFP | | TFP Growth | |
|----|------------------|---------|---------------------|---------|--------------|---------|
| | 2004-08 | 2010-14 | 2004-08 | 2010-14 | 2004-08 | 2010-14 |
| | Average in % | | Average in PP | | Average in % | |
| AT | 2.0 | 1.0 | 1.1 | 0.4 | 1.4 | 0.7 |
| FI | 2.3 | 0.0 | 1.2 | -0.1 | 1.6 | 0.4 |
| SE | 2.5 | 1.5 | 1.2 | 0.2 | 1.3 | 0.8 |
| UK | 2.2 | 0.1 | 1.0 | -0.2 | 1.0 | 0.3 |

| | Potential Growth | | Contribution of TFP | | TFP Growth | |
|-------|------------------|---------|---------------------|---------|--------------|---------|
| | 2004-08 | 2010-14 | 2004-08 | 2010-14 | 2004-08 | 2010-14 |
| | Average in % | | Average in PP | | Average in % | |
| DE | 1.3 | 1.1 | 0.9 | 0.6 | 1.2 | 1.2 |
| DK | 1.4 | 0.4 | 0.6 | 0.5 | 0.5 | 0.7 |
| FR | 1.7 | 1.0 | 0.7 | 0.3 | 0.4 | 0.4 |
| IE | 3.3 | 0.5 | 0.4 | 0.6 | -0.3 | 1.2 |
| EA-18 | 1.8 | 0.5 | 0.7 | 0.4 | 1.1 | 0.6 |

■ Reasons for a Decline of Trend TFP in the Long Run

Population with upper secondary education or higher, annual average over 5 years of rate of change in %



Source: Eurostat

- Change in economic structure, especially a decline of the share of manufacture (high TFP growth rates)
- Declining growth rates of skill acquisition, skill mismatch

Options for Policy with Economic Stagnation

- Permanent effect of the crisis on level vs. growth rate of GDP, empirical evidence from past recessions:
 - Papell and Prodan (2012): Most severe recessions associated with financial crisis in advanced countries do not cause permanent reductions in potential output, but the return to potential output takes on average nine years
 - Benati (2015): estimates sizeable but temporary effects on potential output, but without impact on potential output growth after the crisis
- Economic growth in the eurozone over the coming decades will be lower than in the previous decades because of slowdown/decline of the potential labour force

Effect of the Crisis on TFP Trend

- Ollivaud and Turner (2014) estimate the loss in potential output due to the crisis in 2014 in OECD countries
- Effect on TFP trend in % of a hypothetical counterfactual potential output
- Counterfactual TFP trend: Assuming average growth rates 2000-2007

| | Effect OECD | Effect EK |
|--|-------------|-----------|
| Contribution of TFP to loss in potential output in pp | | |
| AT | -1.5 | -4.7 |
| FI | -9.7 | -12.0 |
| SE | -5.3 | -11.2 |
| UK | -7.4 | -12.0 |

Source: Ollivaud and Turner (2014), EC Autumn Forecast 2014, own calculations

■ In Which Way Can Economic Growth Be Accelerated in Europe?

- Regression of growth rate of GDP on institutional and structural factors
 - GDP could be $I(2)$, then GDP growth could still be not stationary
 - Unit root and cointegration tests of the variables

Thank you for your attention!