

Parallel Session: Potential Growth Discussion

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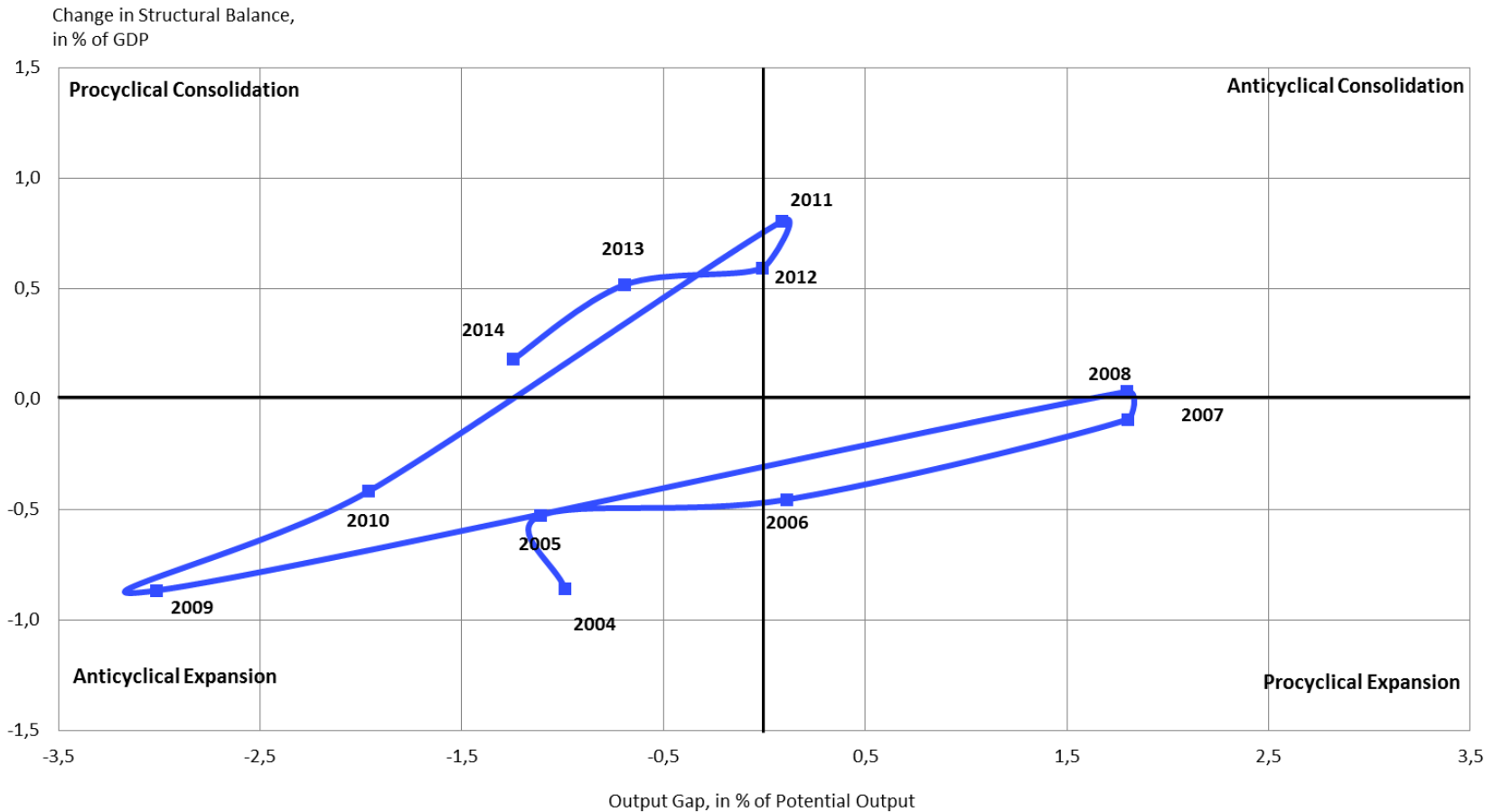
Austrian Fiscal Advisory Council

- 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

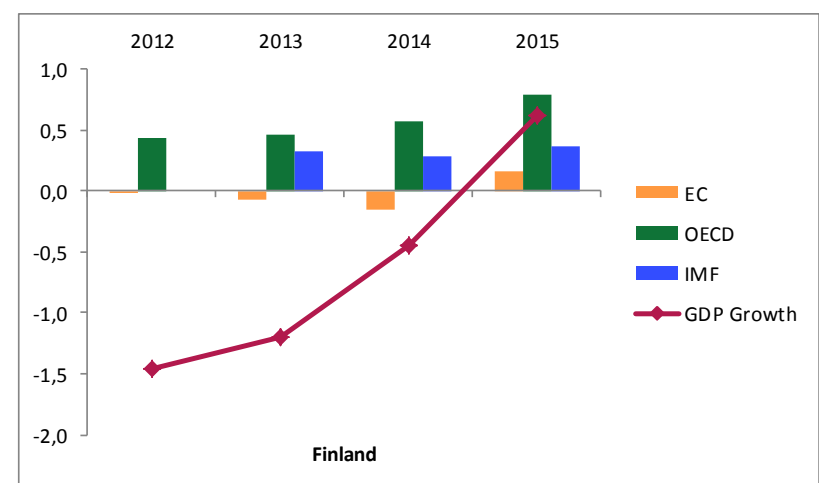
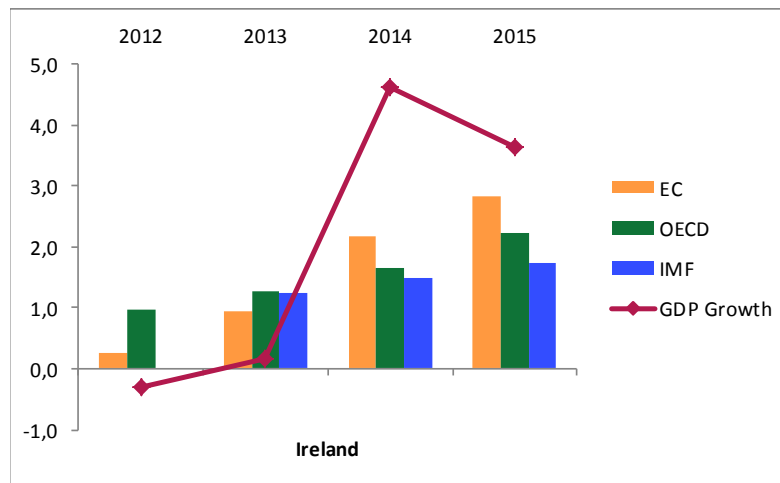
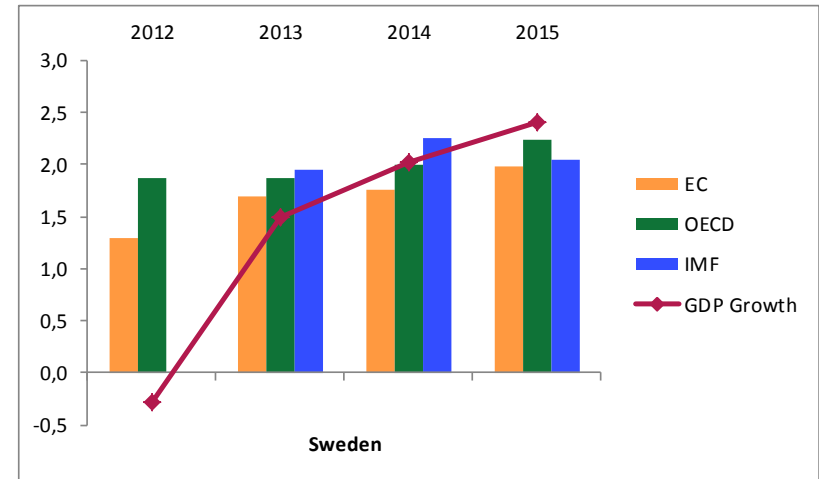
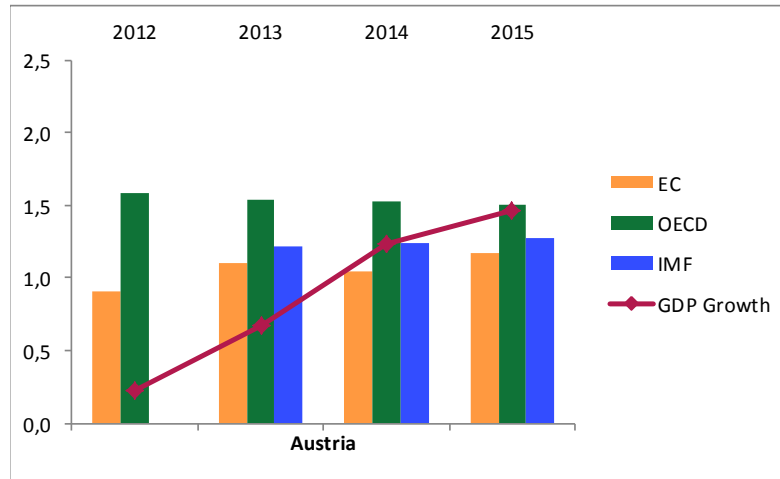
Change in Structural Balance in Austria



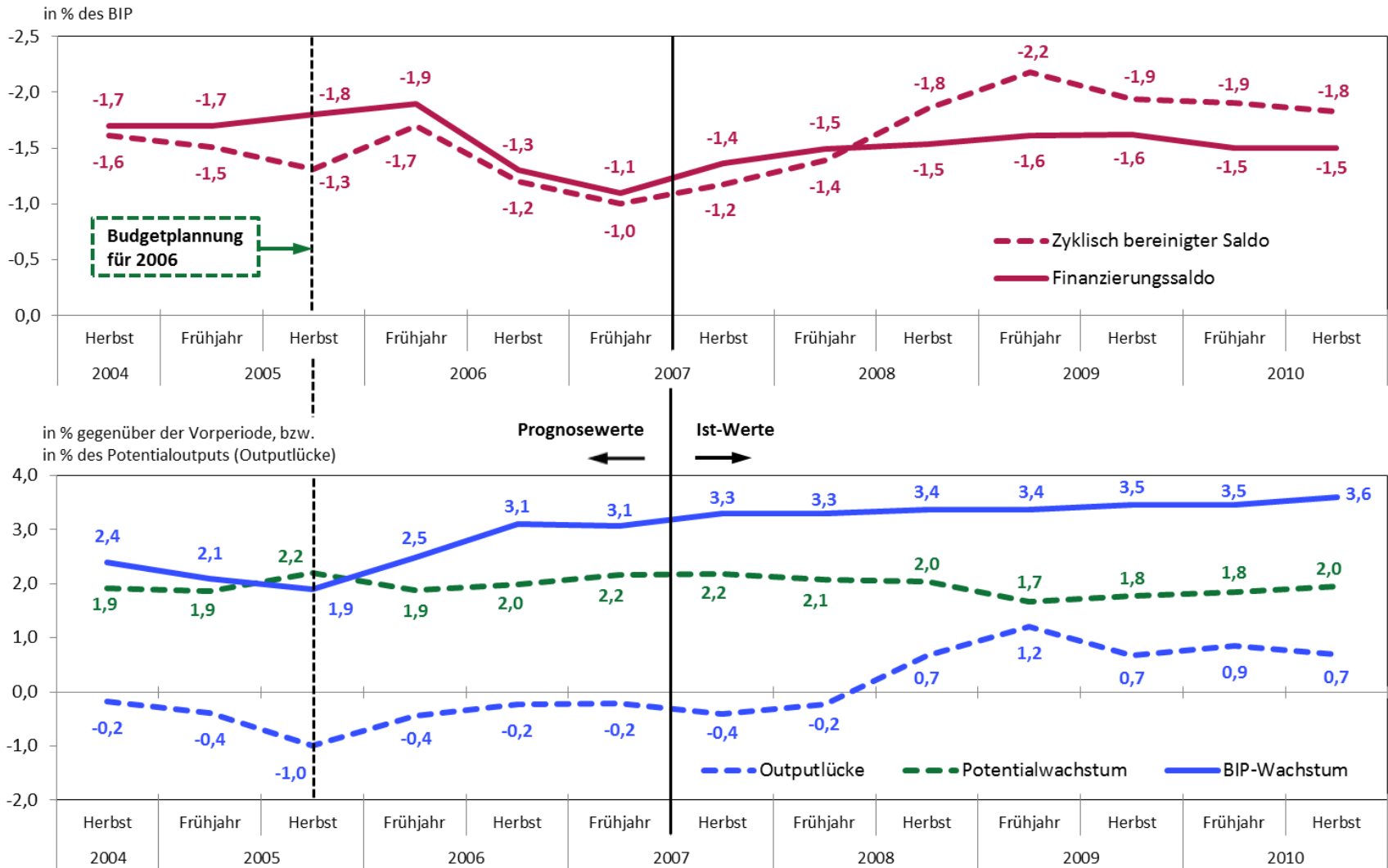
■ Should We Still Use the Concept of Potential Growth ? (II)

- 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 Commission 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

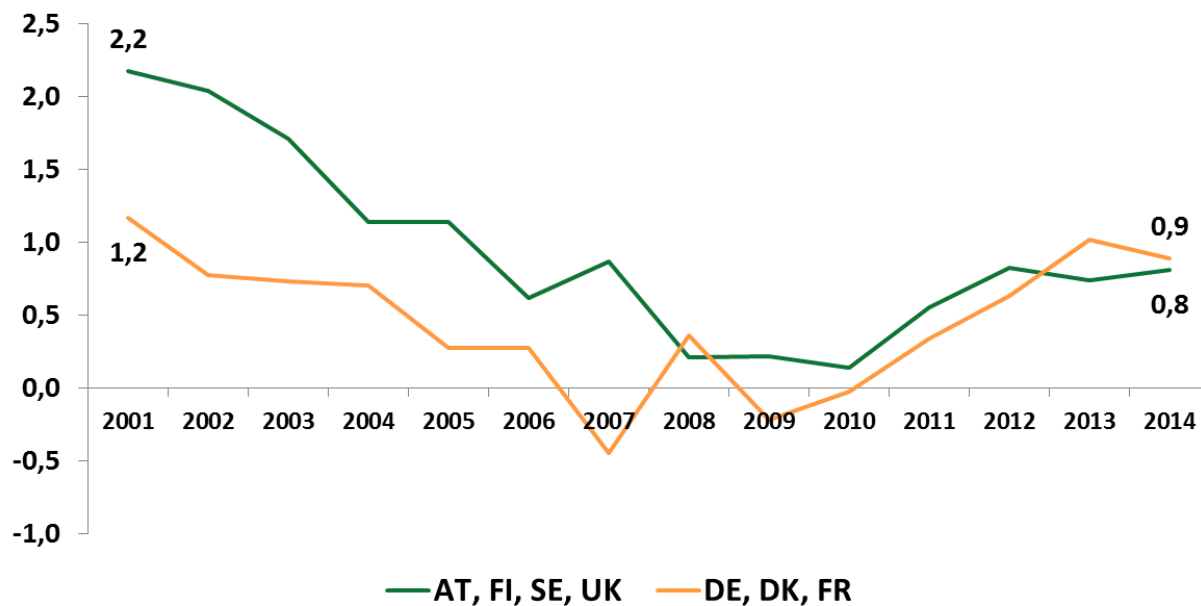
Contribution of TFP to Potential Growth

	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!