



Potential growth and fiscal consolidation in the medium term

Visit of the Danish Parliament's Tax
Committee,
8 September 2010

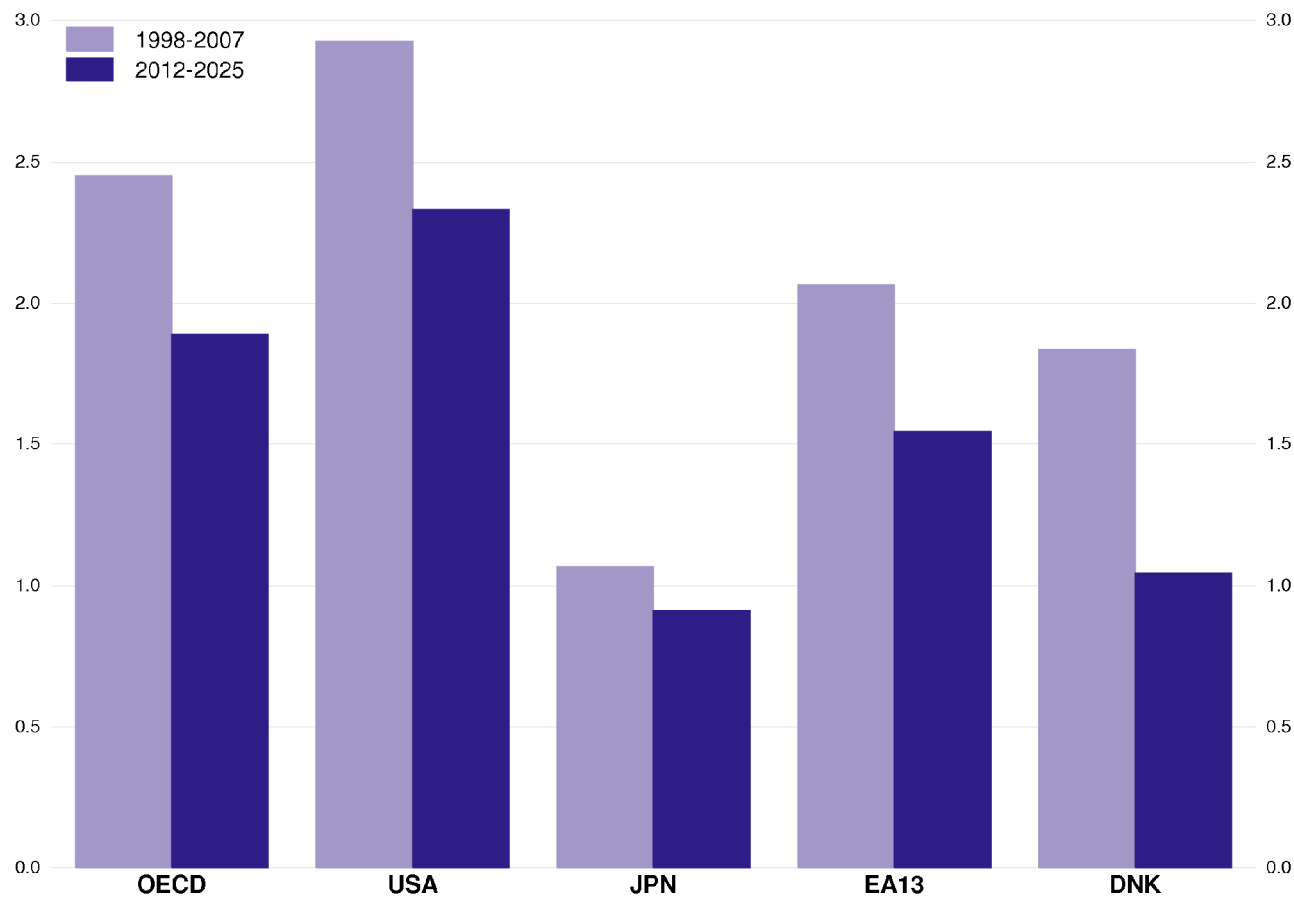
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Organisation of presentation

- How are potential growth rates likely to evolve in the medium term?
- Can policy influence future potential growth rates?
- How will fiscal consolidation affect future potential growth?

Potential growth rates will fall in the medium term ...

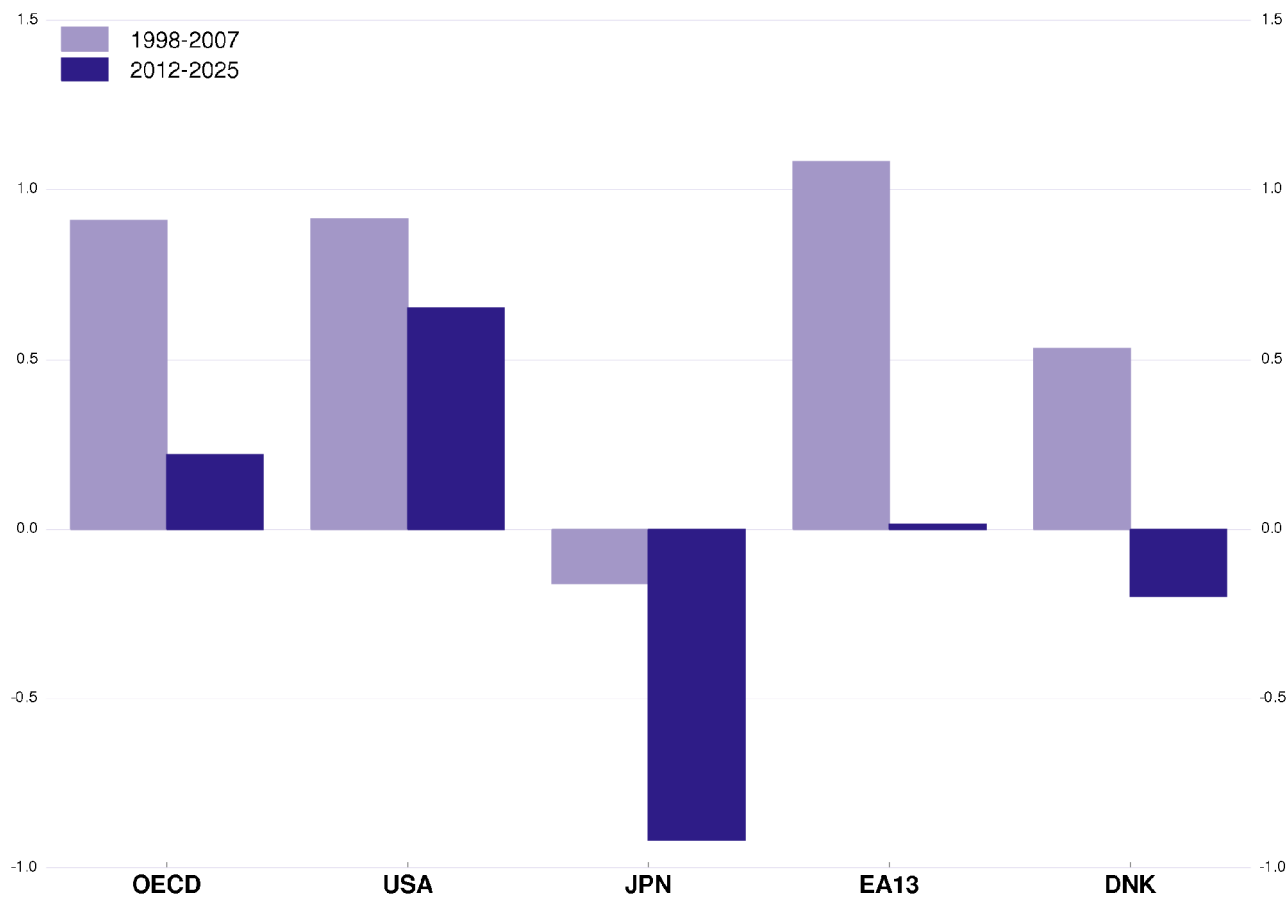
Average annual growth rate (%)



Potential growth prospects

...because employment growth is likely to fall ...

Potential employment, average annual growth rate (%)

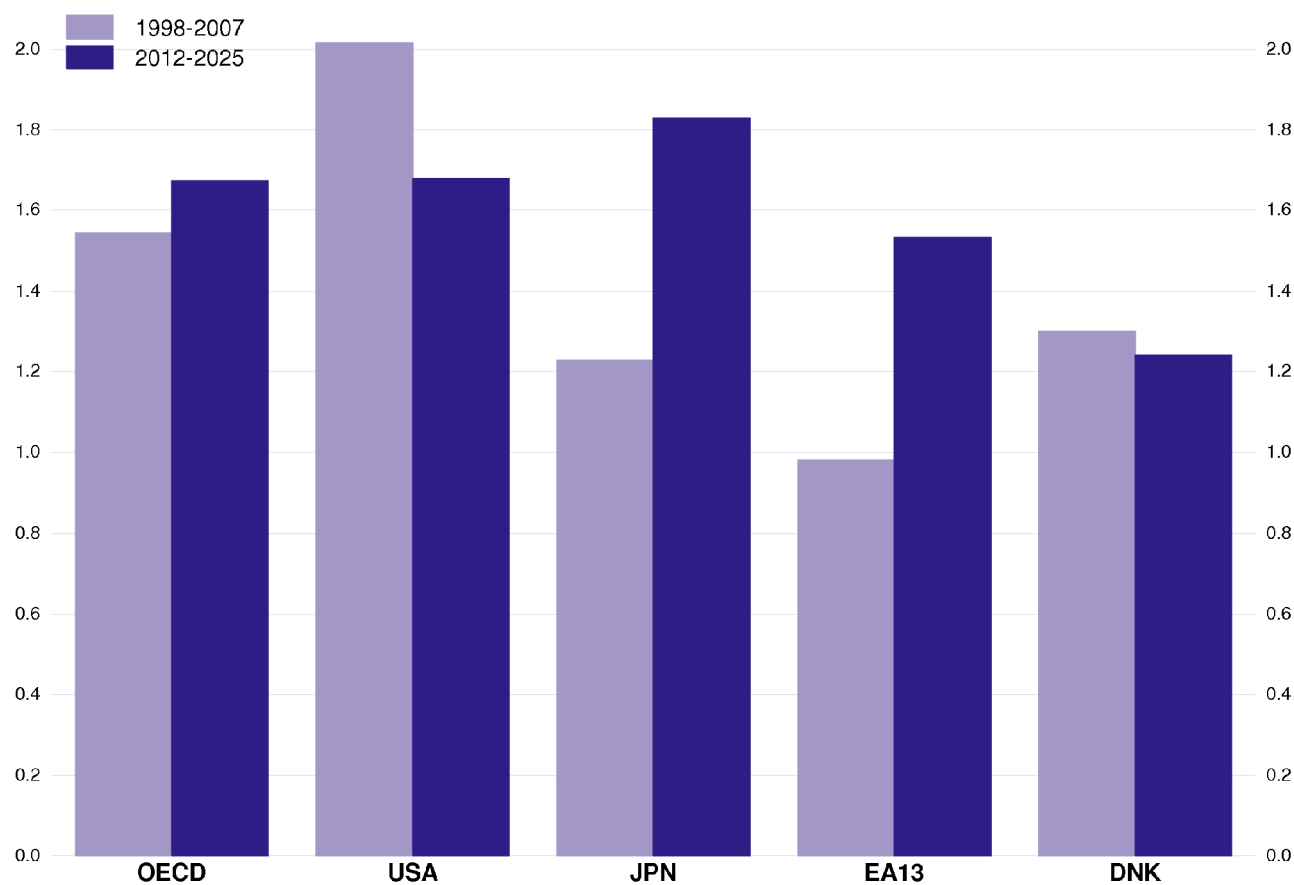


Potential growth prospects

...while labour productivity growth could increase in some countries/areas

Potential growth prospects

Output per employed person, average annual rates



Can structural policies influence potential growth rates?

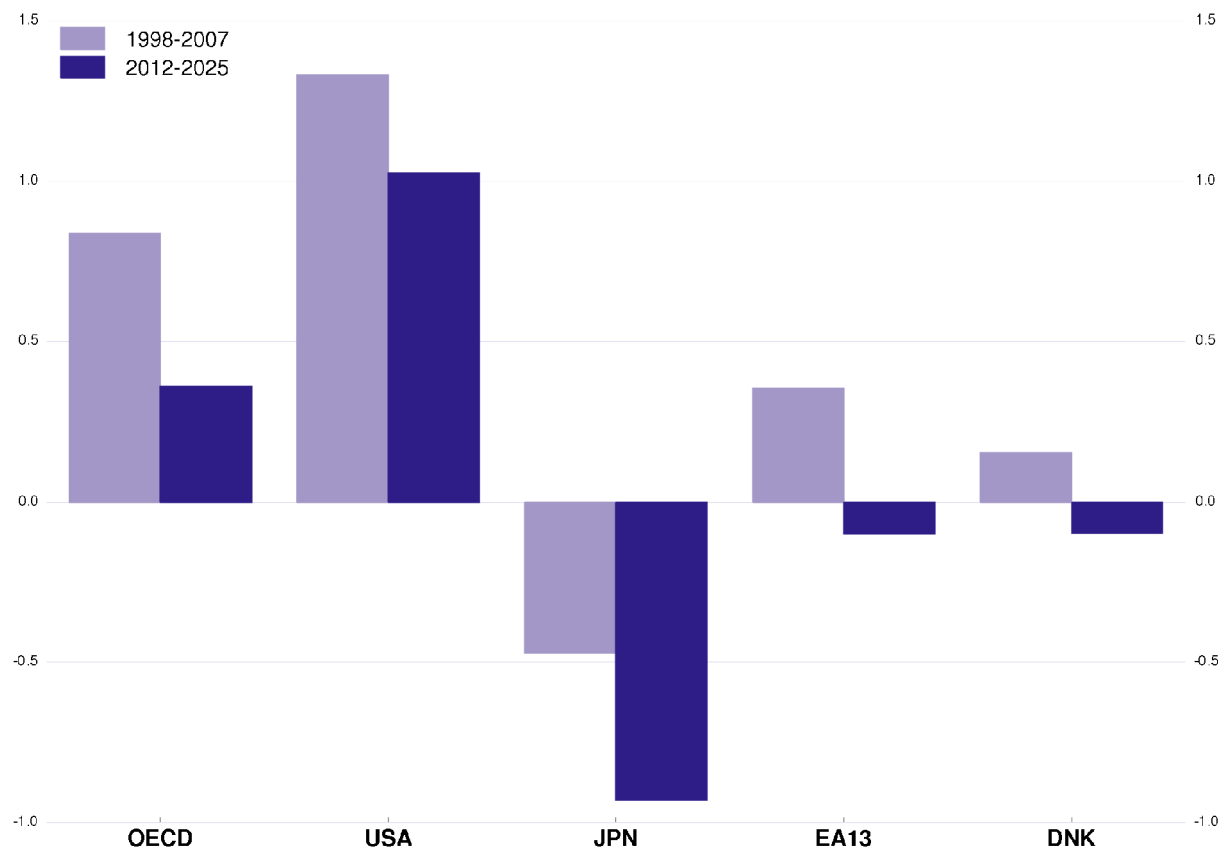
- Can structural policies affect potential employment growth?
 - Working-age population
 - Participation rates
 - Structural unemployment rates
 - Average hours worked
- Can such policies affect productivity growth?
 - Investment and capital intensity
 - “Underlying” productivity growth



Policy cannot affect growth of the working-age population in the medium term

Policy and potential growth

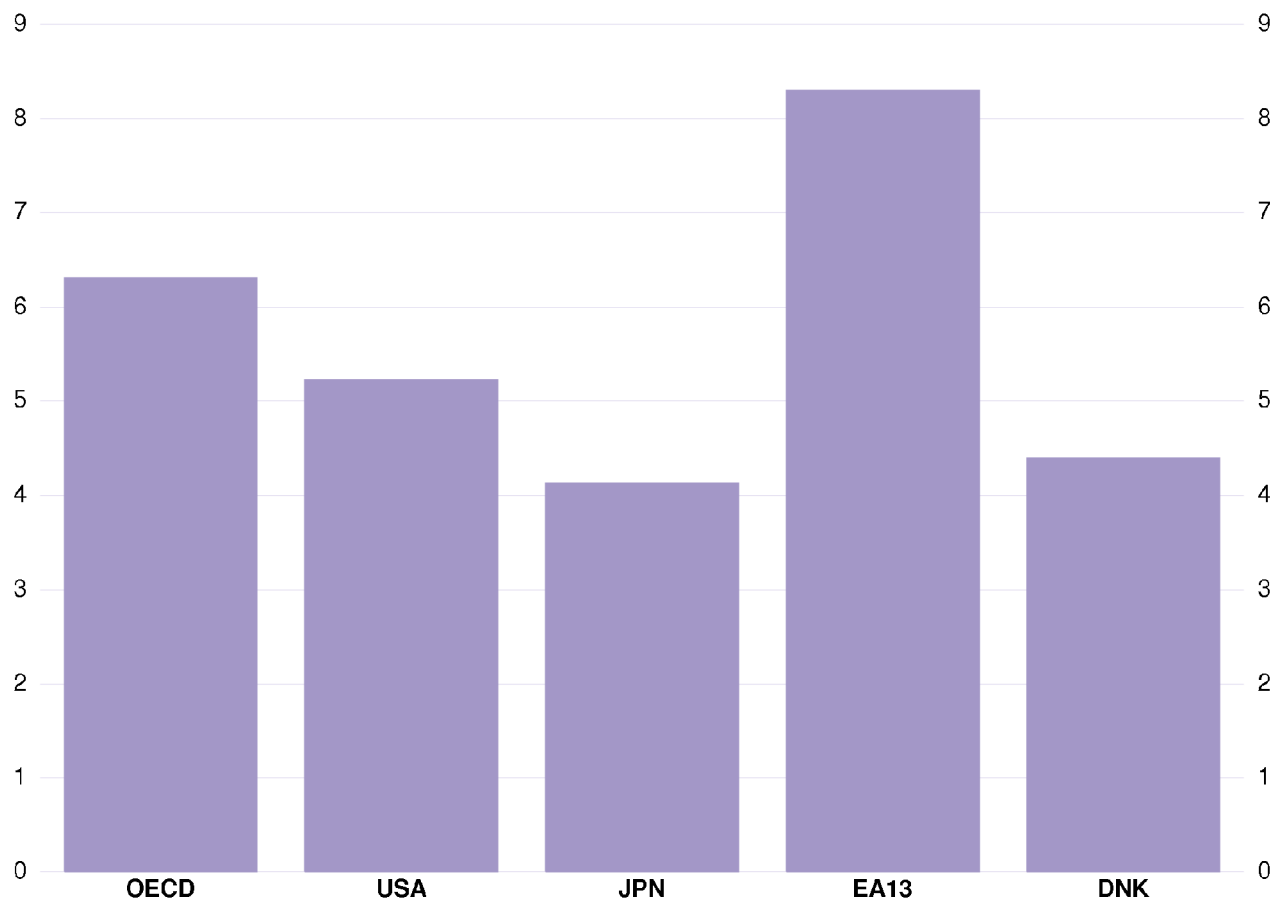
Working-age population, annual average growth rate (%)





Policy can influence structural unemployment rates ...

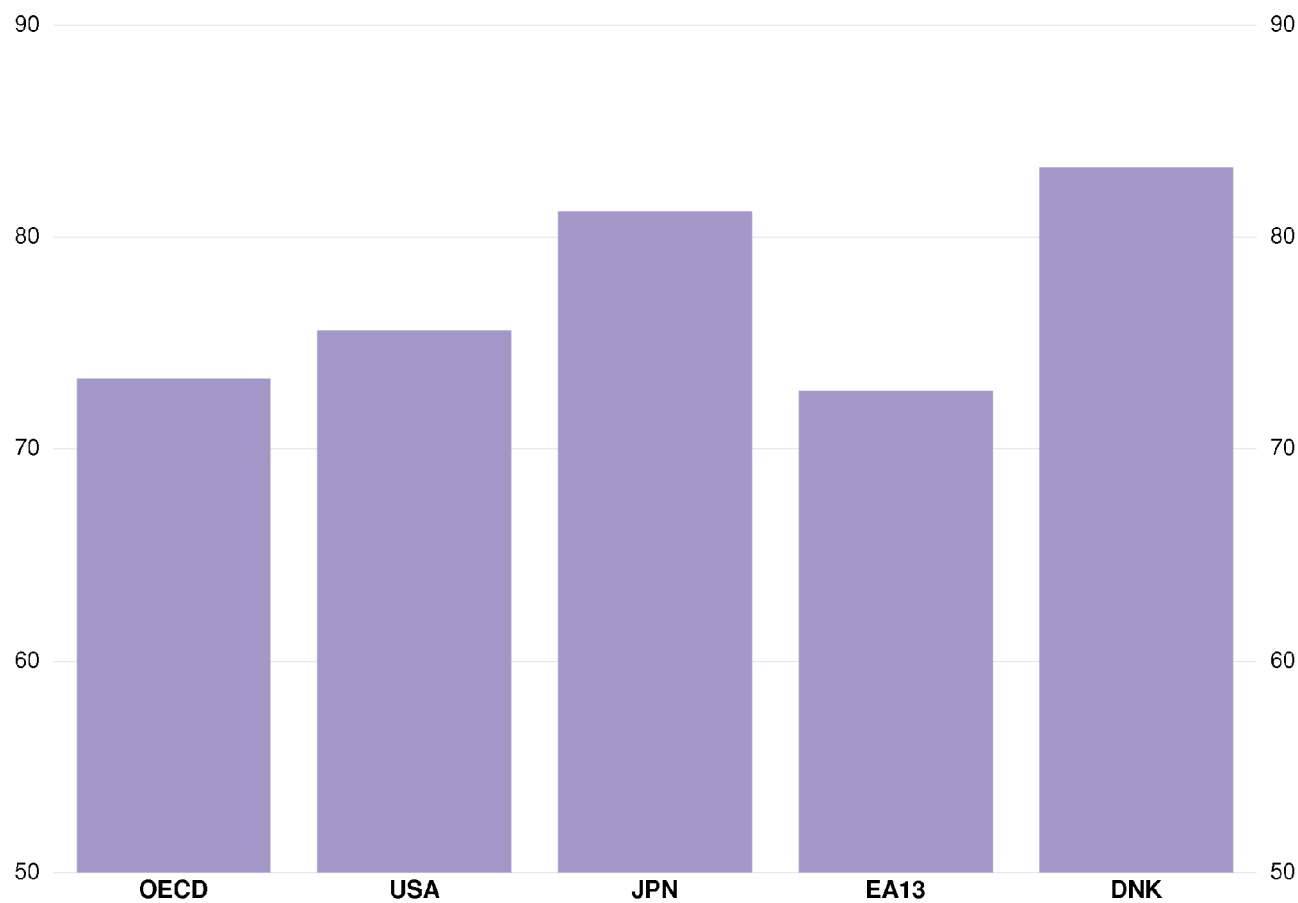
% of the labour force, 2009



Policy and potential growth

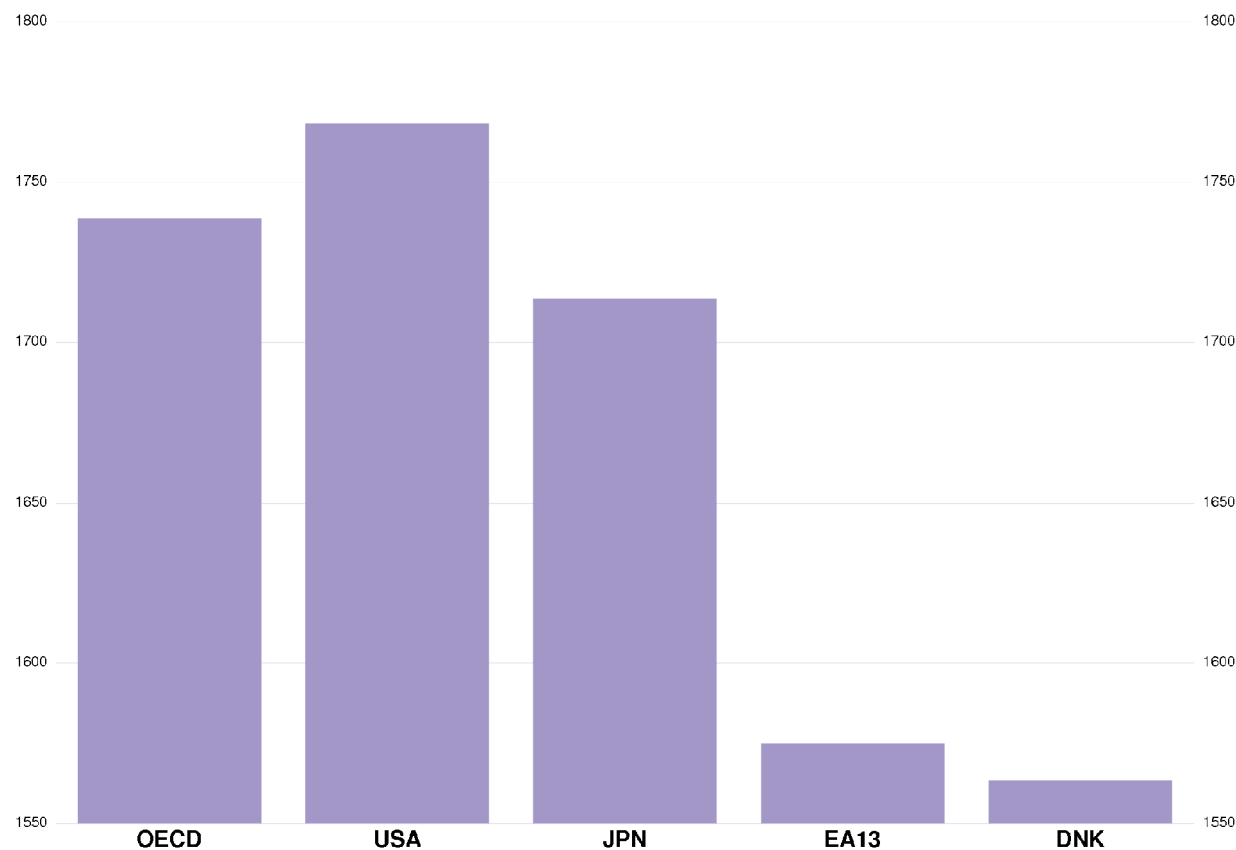
... labour-force participation rates ...

% of working-age population, 2008



... and average hours worked per person

Average annual hours worked per employed person, 2008



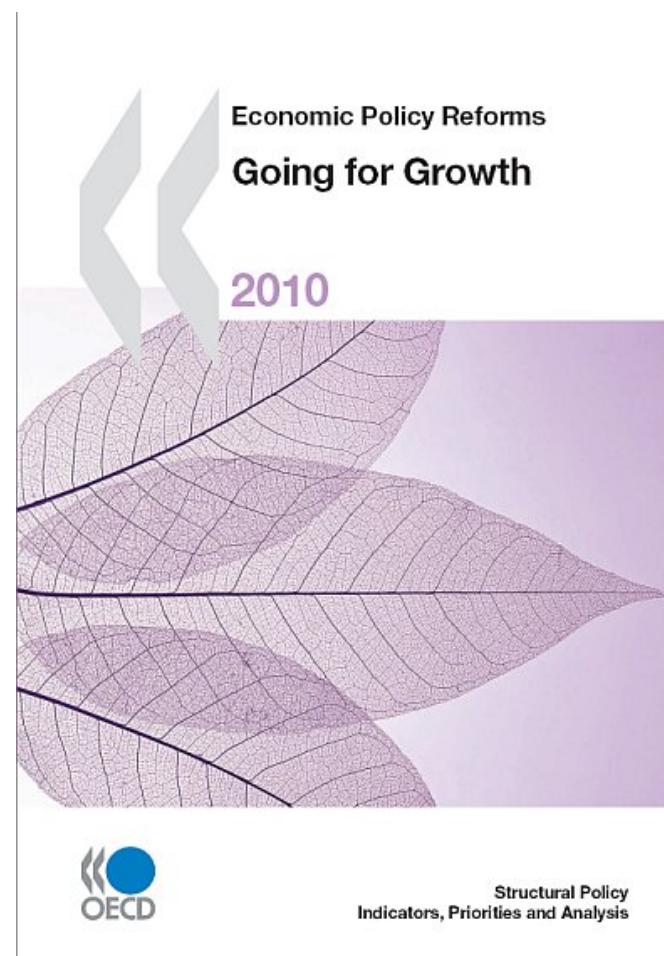
Policies to raise productivity growth in the medium term

- Easing of competition-restraining regulations in product markets.
- Reform of education policies can strengthen human capital accumulation.
- Tax policies can influence the cost of capital and entrepreneurship.

Going for Growth recommendations for Denmark

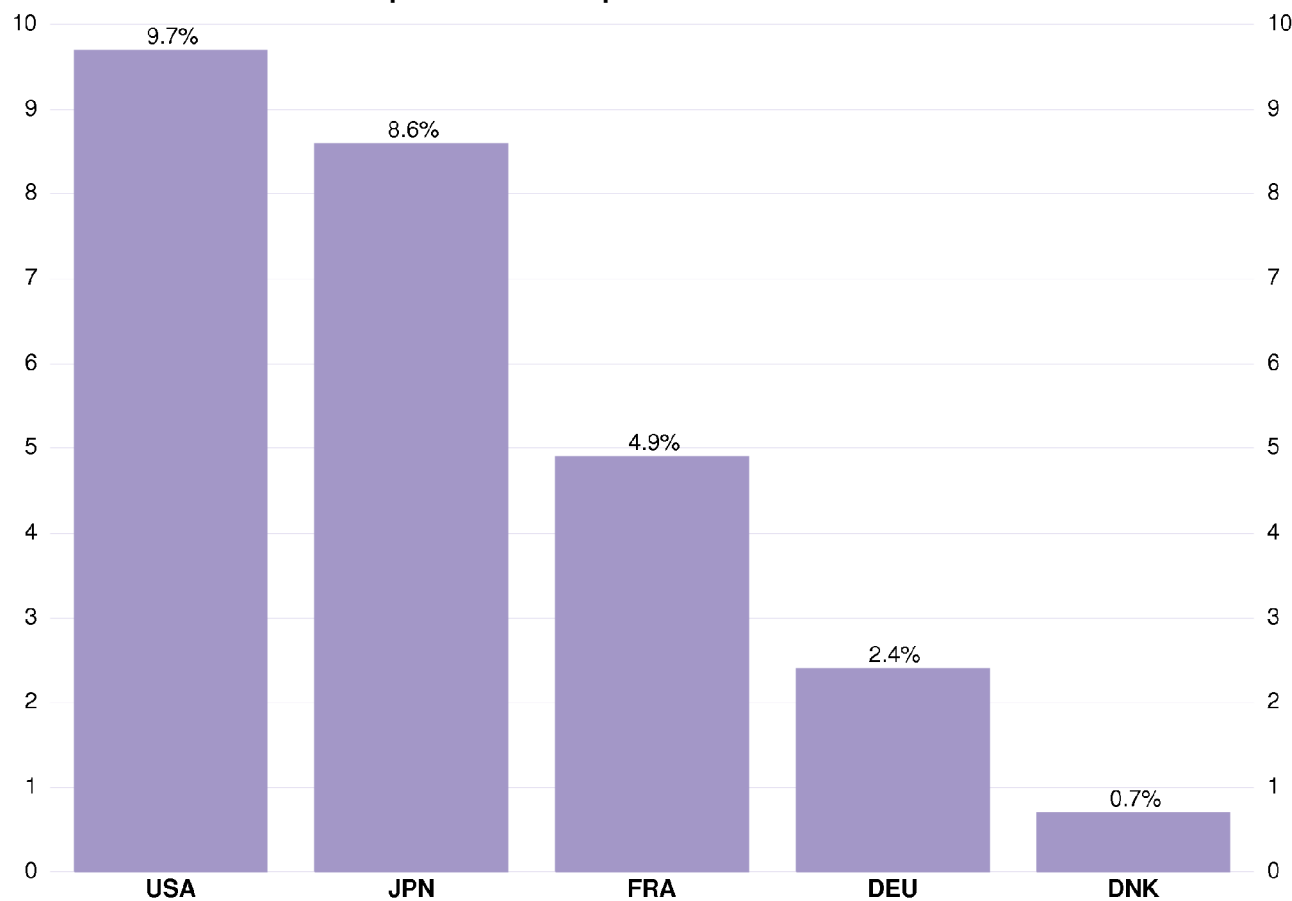
Policy and potential growth

- Reduce marginal taxes on labour income.
- Reform sickness leave and disability benefit schemes.
- Enhance the competition framework.
- Improve the efficiency of the education system.
- Reduce housing subsidies and abolish rent regulation



Budget consolidation requirements

Cumulative budget tightening to stabilise debt ratios by 2025,
per cent of potential GDP



Slow consolidation may raise interest rates

- Stabilising public debt ratios only very gradually would imply additional increases in debt levels and possibly higher interest rates could in turn depress private investment and productivity growth.
- Bringing debt ratios back to pre-crisis levels would imply very strong consolidation in the short term and could lower interest rates, and thus raise investment and productivity growth, but at the cost of a weaker economy in the short run.

The composition of consolidation

- Spending cuts or tax increase? There are practical and fundamental reasons for relying on spending cuts, but tax increases may also have a role to play.
- Composition of spending cuts:
 - Public consumption: Cuts will be necessary. However, avoid reducing outputs of growth-friendly public services by exploiting scope for efficiency improvements.
 - Public transfers: Remove subsidies to businesses unless they are efficiency improving and exploit scope to reduce social benefit spending without compromising equity objectives.
 - Public investment: Avoid reducing investment that is profitable on the basis of cost-benefit analysis.
- Composition of tax increases: Next presentation.

Thank you!

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