COMMENTS ON SESSION 2
FISCAL IMPULSE

Galen Countryman[*]

These three papers make interesting contributions to the discussion of fiscal policy. The papers by Baldacci *et al.* and Afonso *et al.* explore the important topic of whether fiscal policy can be effective in the wake of a financial crisis. The paper by McDonald and Johnson has a somewhat different angle: it explores how tax policies may have contributed to the recent financial crisis and what policy changes could be made to limit this effect.

Comments on "Getting It Right: How Fiscal Response Can Shorten Crisis Length and Raise Growth" by Emanuele Baldacci, Sanjeev Gupta and Carlos Mulas-Granados

This paper examines historical data to determine what type of fiscal stimuli work best in the context of a banking crisis. The authors find that fiscal expansions are a decisive factor in reducing the duration of banking crises. However, they note that different fiscal stimuli have different effects and that there is a trade-off between short-term and medium term objectives. To spur recovery in the short-term, the fiscal stimuli need to be of the sort that can be implemented rapidly. In this regard, tax cuts, particularly consumption tax cuts, as well as government consumption are found to work best. However, some of these instruments are not as effective in contributing to long-term growth. For instance, spending on infrastructure and other capital, which given the lead time for implementation, doesn't have much of an impact on shortening a crisis but was particularly effective in contributing to long-term growth.

The authors also demonstrated empirically that having a sound fiscal position before the crisis hits is important since it provides governments with the flexibility to use fiscal policy to mitigate the effects of a banking crisis. Indeed, the authors find that high-debt, low-income countries have a harder time recovering from the crisis since their ability to resort to fiscal policy is limited.

This paper makes an interesting contribution in exploring the choice of fiscal stimuli to combat the effects of a financial crisis. An interesting extension of this analysis would be to examine the choice of fiscal measures and their effect on long term fiscal sustainability. In this context, time-limited spending may have an advantage over tax cuts, which tend to be more permanent.

Comments on "Fiscal Policy and Growth: Do Financial Crises Make a Difference?", by António Afonso, Hans Peter Grüner and Christina Kolerus

The paper by Afonso *et al.* empirically explores the question of whether fiscal policy works differently in a financial crisis versus a "regular" recession. The authors find that there is no statistical effect to show that fiscal policy is any more effective in a financial crisis than during a non-financial one. Indeed, they find that fiscal multipliers are relatively small.

[*] Department of Finance, Canada.
The views expressed here are those of the author and do not necessarily reflect those of the Department of Finance, Canada.

While this paper addresses an important question, it is limited by the fact that it does not control for the monetary policy stance at the time of the crisis (indeed, it may not be possible due to data limitations). A key aspect of the current crisis was that monetary policymakers were quickly running out of tools – what we now refer to as the "zero lower bound". Indeed, another paper presented in this session by Röger and Jan in 't Veld suggests that fiscal multipliers are in fact larger during financial crises.

Comments on "Tax Policies to Improve the Stability of Financial Markets" by Jason McDonald and Shane Johnson

The paper by McDonald and Johnson explores how long-standing tax policies common to many countries could have been a factor in the latest financial crisis. These policies include interest deductibility, which leads to a bias towards debt financing, and the preferential treatment of owner-occupied housing, which creates an incentive for individuals to invest in housing versus other investment vehicles. The authors provide a good qualitative summary of the relevant policy issues, and in the last part of the paper, propose some possible reforms. Such reforms may be difficult to achieve, given that they often involve transitional costs or the loss of preferences by certain groups of taxpayers.

The draft of the paper presented at the conference included a middle section discussing financial transaction taxes and their ability to reduce systemic risk, recover the costs of government assistance provided after the collapse of financial firms, and tax economic rents in the financial sector. Given recent proposals concerning the taxation of financial institutions, this discussion is quite timely. The authors provide a good discussion of the issues involved and conclude that proposals to tax financial transactions pose a number of challenges. In particular, some taxes may not achieve their desired outcome.

This paper provides a very good review of tax policies and a reminder of how these rather microeconomic policy instruments can have profound macroeconomic effects. My one comment on this paper this that middle section on financial transaction taxes, while useful, seems out of place with the rest of the paper. Consideration should be given to turning this section into a separate paper or finding a way to better integrate this section into the rest of the paper.