COMMENTS ON SESSION 4
POLICIES TO PROMOTE SUSTAINABLE GROWTH

Sergey Vlasov[*]

The two papers on which I would like to comment, prepared by OECD and Serbian colleagues, cover very different topics. So, let me take these papers up in turn.

1 Comments on "Fiscal Consolidation Needs and Implications for Growth" by Jørgen Elmeskov and Douglas Sutherland

The paper prepared by Elmeskov and Sutherland studies the instruments of public debt levels adjustment with the implications for growth in OECD area. It is a very accurate, well-built paper, mainly descriptive, but supported with the corresponding calculations made by authors themselves or their OECD colleagues.

The motivation of the paper is the dramatic increase in the public debt in the OECD area that has trended upwards since early 1970s and passed annual GPD in 2011 both because of the pro-cyclical fiscal policy during the expansion before the crisis and severe crisis consequences. High public debt, in its turn, has adverse effects on economic growth by raising the costs of capital – reducing productivity and leading to a level shift in potential output in the short run and reducing investment in research and development in the long run – and by crowding out effect – the real interest shock. So, there is a clear necessity to reduce debt overhangs, including creating some room to react to possible future shocks.

Now let me turn to the main findings as well as to make some comments. Talking about the size of adjustment in OECD area the authors present the calculations of what has already been done or is under way as well as what should be done in the long run. What is interesting to note is that Greece, Portugal, Spain and Ireland, the countries associated with possible debt crisis in Euro area, not just make the largest cumulative fiscal tightening between the deficit trough and 2012 (as we can see in Figure 4) but also have the modest adjustment needs on a period till 2050 under conditions of bringing down gross financial liabilities to 50 per cent of GDP (with the only exception for Ireland – see Figure 5). First, how big is the risk that in 2012 the reporting figures would not correspond to those planned? For example, the situation in Greece – I mean considerable public protest against fiscal consolidation measures adopted by the government – allows to suppose that the expected effect will not be fully achieved (directly or indirectly). Second, how do the authors' estimations correlate with the low sovereign ratings given to these countries by international rating agencies and, for instance, the speech of the head of the World Bank, R. Zoellick, who told relatively not long ago that Greece will inevitably default and it is just a matter of time? Possibly there is a preliminary estimation on 2012 to support authors' calculations?

The debt overhang can be worked off in two ways. The first is by primary balance tightening and the second is by using the real growth and real interest rate effects. Let me start from the latter one by looking at first at the Russian experience. Following the Asian financial crisis and the deterioration of external conditions the Russian government had to declare a sovereign default and to allow the depreciation of the Russian ruble. The federal government debt increased dramatically to 137.4 per cent of GDP by the end of 1998. But only about half a decade later GDP growth effect,

[*] Bank of Russia.

Figure 1

Components of the Russian Federal Government Debt Dynamics in 1996-2000 (left axis) and 2001-2011 (right axis)

(percent of GDP)

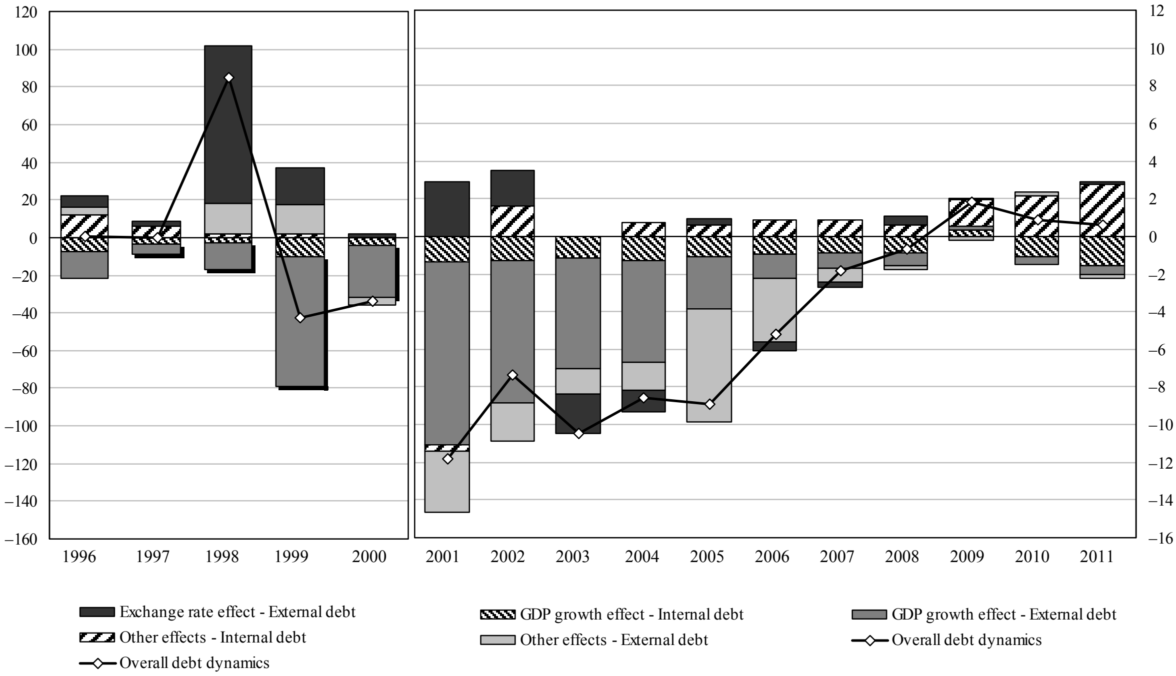
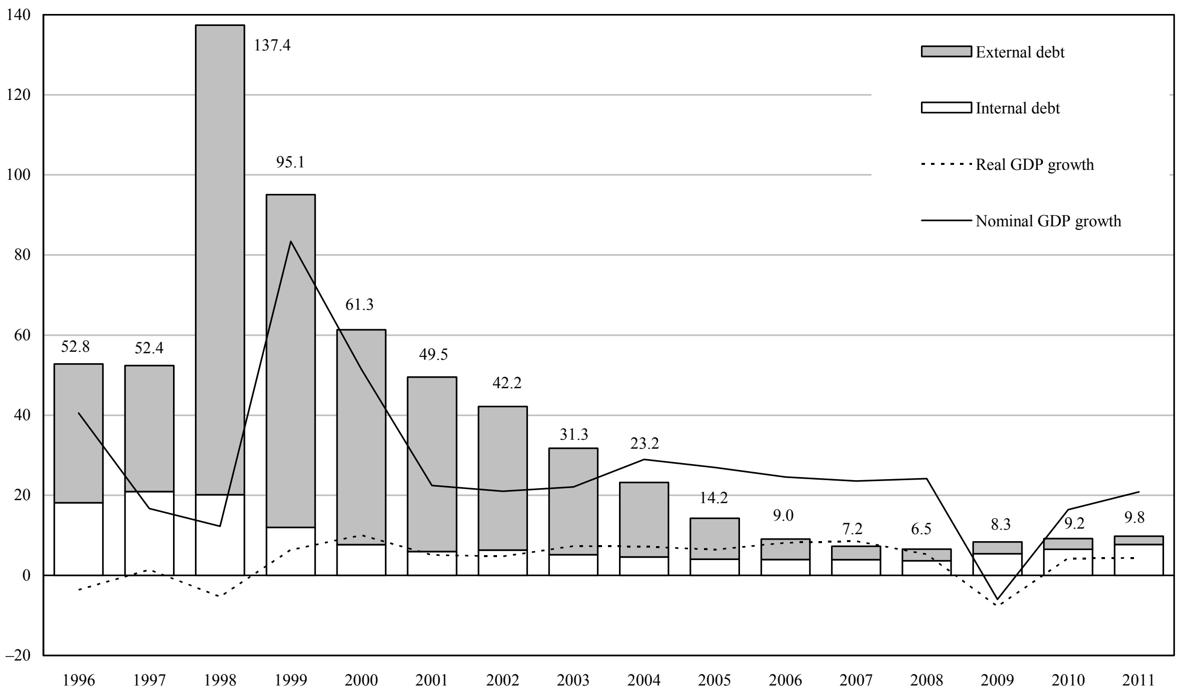


Figure 2

Dynamics and Structure of the Russian Federal Government Debt

(percent of GDP and nominal and real GDP growth rates in 1996-2011)



supported by favourable external conditions and prudent fiscal policy, allowed to reduce the public debt level from one of the highest in the world to one of the lowest ones (see Figures 1 and 2).

Probably this is not the case for the OECD countries and authors' calculations fully support this idea (see Table 2 for the corresponding calculations of real growth effect). So, the authors analyze a wide range of possible instruments of fiscal consolidation and quantify their contribution to primary balance tightening for each country (see Table 3). While implementation of the most of them seems reasonable there are some risks and limitations that have to be taken into account. Also several general comments could be made.

First, I have some doubts about the possibility to use OECD average as a target value for a set of instruments, e.g. social transfers, subsidies, tuition fees, as countries' peculiarities seem worthwhile to be taken into account. For instance, high values of social indicators in the Scandinavian region is a distinctive feature of the policy in these countries, partly concerned with their tax system.

Second, the level of discontent among the population as a result of possible employees' layoffs, social spending cuts and even increase in so-called "sin" taxes should be taken into account.

Third, it seems worthwhile to pay more attention in the paper to the pension reform: how it should be carried out and the corresponding calculations. This issue is very complicated and should become an important contribution to the fiscal tightening. For example, the Russian government, in contrast to the most of the countries, has an intension to avoid retirement age rise and find the required financial resources by reviewing the pension system components. This decision reflects possible political costs as the share of pensioners in the electorate is more than a third at present and presumably will rise gradually in the long run.

Fourth, it should be interesting to see how substantially can the primary balance be improved through the of automatic stabilizers operation. Although the model that is used to calculate fiscal gaps (see Appendix) implies the use of automatic stabilizers while the economy moves back to potential output, the paper does not present the corresponding calculations of their size for OECD and/or individual countries.

Finally, the paper contains the discussion of the choice of instruments based on their possible effect on long-term growth, e.g. that the differences in multipliers make tax increases more attractive than the government spending cuts. But it would be a nice contribution to the paper if the authors could estimate (at least make rough calculations of) the effect of fiscal consolidation (measures) on GDP growth rates for OECD and/or individual countries.

2 Comments on "Equity Aspects of VAT in Emerging European Economies: The Case Study of Serbia" by Nikola Altiparmakov and Milojko Arsić

The paper by Altiparmakov and Arsić is rather specific and aimed at proving VAT progressiveness in Serbia by investigating the VAT system in very details.

The motivation of this paper is the existence of the world-wide trend, aimed specifically at boosting the economic growth, of shifting the tax burden from income to consumption taxation, in particular VAT. At the same time there is common belief in the general public that VAT is a regressive tax that has an adverse distributional effects by creating disproportionate tax burden on the poor households. So, using the micro-level data the authors investigate equity aspects of VAT in Serbia as a typical emerging European country to prove its progressiveness.

Let me turn to the main findings of the paper. In order to determine whether the VAT is progressive or regressive the authors make calculations of the effective VAT rate for ten deciles of the population: from the poorest to the richest. Following the common practice the authors first investigate VAT burden by household annual income. It yielded unreasonable results indicating that the poorest group's of population effective VAT rate lies outside the range from 0 per cent the standard VAT rate (see Table 5a). These results show VAT regressiveness and are explained by the significant presence of the shadow economy and the evasion of direct income taxes in emerging market economies and by relying on annual income framework instead of lifetime income framework.

On the contrary, investigating VAT burden by looking at household annual expenditure leads to reasonable results and allows disclosing VAT progressiveness (see Table 5b). In about 60 per cent of the effect of progressivity is explained by taxation under reduced rate, while the remaining by progressive incidence of own-farming production, which is widely used in Serbia.

Finally, the authors investigate the prospective increase in VAT burden in Serbia by examining three possible scenarios. They conclude that introducing the uniform rate by eliminating the reduced rate contributes to regressivity and should be chosen only if accompanied with progressivity-enhancing reforms (see Table 7 for results).

There are three comments that I would like to make.

First, as a representative of another typical emerging European country which is very close to Serbia in many aspects, including those close to the topic of the paper (significant presence of the shadow economy and the evasion of direct income taxes, widely used own-farming production and VAT system as a whole), and basing on the Russian experience, let me express some doubts about the common (mis)belief in general public in Serbia that VAT is a regressive tax. I believe that scientists or politicians care about this issue, in particular the latter ones can use it in their political activity. At the same time I guess common people resist the prospective increase in VAT burden not because they believe that this tax burdens poor individuals more but because they resist the increase in tax burden at all.

Second, it would be a good contribution to the paper if authors would present their proposals how to modify VAT system in Serbia basing on such aspects as offering special consumption incentives, boosting economic growth, improving fiscal sustainability etc. They may include not only the suggestions of eliminating reduced rate or exemption from VAT for certain goods but any tax relief as well. For instance, in accordance with the Russian VAT system goods for children are a subject to the reduced VAT rate. It allows to promote their consumption and, therefore, to increase fertility rate.

Finally, is there any effective VAT rate for achieving the most of redistributive objectives, e.g., as the share of the standard VAT rate, especially for the poorest households? May be some literature on this issue exists?