Fiscal Discipline Under Scarring: Do Grand Spending Plans Lift Growth and Curb Debt?

P. Claeys

Abstract-

Concerns about faltering productivity have led to calls for grand fiscal strategies to ignite economic growth. Targeted spending sprees are believed to be lifting economies out of stagnation. This policies shift stands in stark contrast to the type of fiscal restraint (austerity) advocated after the Global Financial Crisis. This paper examines whether fiscal policy can lift economic growth after recessions characterised by prolonged economic stagnation – also known as scarring-while keeping debt under control. I find the odds of such an expansionary debt-reducing fiscal policy are limited due to a typical deficit bias in the short term – a combination of much lower tax revenues and reduced government spending – and the use of tax-based consolidations in the longer run. Higher taxes even push governments to raise spending to higher levels a decade after the recession. The combination of procyclical fiscal policy in the short term, with distortionary tax increases in the long term is unlikely to lift productivity growth.

Index Terms- fiscal policy; recession; scarring; debt; growth

Citation:
Claeys, P. "Fiscal Discipline Under Scarring: Do Grand Spending Plans Lift Growth and Curb Debt?", The Economists' Voice, , .