

EXECUTIVE SUMMARY

Chapter 1: Saving for a Rainy Day

Strong and broad-based growth provides an opportunity to begin rebuilding fiscal buffers now, improve government balances, and anchor public debt. Strengthening fiscal buffers in the upswing will create room to provide fiscal support in an eventual downturn and will prevent fiscal vulnerabilities from becoming a source of stress if financial conditions deteriorate.

High Debt Is a Concern

Global debt is at historic highs, reaching the record peak of US\$164 trillion in 2016, equivalent to 225 percent of global GDP. The world is now 12 percent of GDP deeper in debt than the previous peak in 2009, with China as a driving force.

Public debt plays an important role in the surge in global debt, reflecting the economic collapse during the global financial crisis and the policy response, as well as the effects of the 2014 fall in commodity prices and rapid spending growth in the case of emerging markets and low-income developing countries. Debt in advanced economies is at 105 percent of GDP on average—levels not seen since World War II. In emerging market and middle-income economies, debt is close to 50 percent of GDP on average—levels last seen during the 1980s debt crisis. For low-income developing countries, average debt-to-GDP ratios have been climbing at a rapid pace and exceed 40 percent as of 2017. Moreover, nearly half of this debt is on nonconcessional terms, which has resulted in a doubling of the interest burden as a share of tax revenues in the past 10 years. Underpinning debt dynamics for all countries are large primary deficits, which reached record levels in the case of emerging market and developing economies.

High government debt and deficits are cause for concern. Countries with elevated government debt are vulnerable to a sudden tightening of global financing conditions, which could disrupt market access and put economic activity in jeopardy. Moreover, experience shows that countries can be subject to large, unexpected shocks to public debt-to-GDP ratios, which

would exacerbate rollover risks. It is important to note that large debt and deficits hinder governments' ability to implement a strong fiscal policy response to support the economy in the event of a downturn. Historical experience shows that a weak fiscal position increases the depth and duration of recession—such as in the aftermath of a financial crisis—because governments are unable to deploy sufficient fiscal policy to support growth. Building fiscal room to maneuver is especially relevant now that private sector debt is at record highs and rising. Excessive private debt in some countries puts them at risk of an abrupt and costly deleveraging process.

Enhancing Resilience and Buttressing Growth

Decisive action is needed now to strengthen fiscal buffers, taking full advantage of the cyclical upswing in economic activity. As growth returns to its potential, fiscal stimulus loses its effectiveness while the cost of fiscal consolidation diminishes, making it easier to switch from fiscal expansion to fiscal consolidation. It is important to note that building buffers now will help protect the economy, both by creating room for fiscal policy to step in to support economic activity during a downturn and by reducing the risk of financing difficulties if global financial conditions tighten suddenly. In general, countries should allow automatic stabilizers (that is, tax and spending that moves in sync with output and employment) to operate fully, while making efforts to put deficits and debt firmly on a downward path toward their medium-term targets.

The size and pace of adjustment need to be calibrated to each country's cyclical conditions and available fiscal space to avoid an undue drag on growth. In economies operating at or near potential output and where debt to GDP is at high levels, fiscal adjustment should be implemented. In the United States—where a fiscal stimulus is happening when the economy is close to full employment, keeping overall deficits above \$1 trillion (5 percent of GDP) over the next three years—fiscal policy should be recalibrated to ensure that the government debt-to-GDP ratio declines over the medium term. Where fiscal space is limited, there

is little choice but to undertake consolidation efforts to reduce fiscal risks, based on policies that will support medium-term growth. A few advanced economies that have ample fiscal space and are operating at or close to capacity have room for using fiscal policy to facilitate the implementation of pro-growth structural reforms. Despite the recent partial recovery in commodity prices, commodity exporters should continue to adjust to ensure that spending is aligned with medium-term revenue prospects. Several low-income countries need to make room in their budgets to accommodate the implementation of infrastructure plans by mobilizing revenues, rationalizing spending, and improving spending efficiency.

At the same time, all countries need to keep their sights on policies to lift their medium-term growth outlook. Indeed, recent fiscal adjustment in some countries has not necessarily prioritized growth-friendly measures, as illustrated by the decline in public investment spending as a share of GDP among advanced economies and commodity exporters. Advanced economies should focus on seeking efficiency gains in spending and rationalizing entitlements to make room for more public investment, incentives for labor market participation, and improvements in the quality of education and health services. Some advanced economies would also benefit from broadening tax bases and upgrading the design of their tax systems. For emerging market and developing economies, the priority is to raise revenue to finance critical spending on physical and human capital and social spending. All countries should promote inclusive growth to avoid excessive inequality that can impede social mobility, erode social cohesion, and ultimately hurt growth.

Chapter 2: Digital Government

The world is becoming digital and so are governments, albeit at sharply different paces. Almost all country governments now have national websites and automated financial management systems. Digitalization presents both opportunities and challenges for fiscal policy. How can digitalization change the design and implementation of policies now and in the future? And what stands in the way?

Greater availability and access to timely and reliable information can transform how governments operate. Digitalization can reduce the private and public costs of tax compliance and can improve spending efficiency.

For example, governments can use digital tools to tackle cross-border fraud—adopting digital tools could increase indirect tax collection at the border by up to 1–2 percent of GDP per year. Digitalization could also help governments track down taxes on wealth sheltered in low-tax jurisdictions, estimated at an average of 10 percent of world GDP. Although the potential revenue gains from this traditionally inaccessible tax base are low at current tax rates, digitalization could facilitate future tax collection on income at the source before it escapes the reach of tax authorities. On the spending side, the experiences of India and South Africa show how digitalization can help improve social protection and the delivery of public services.

In the future, the increasing digitalization of businesses—and the emergence of digital giants such as Google, Apple, Facebook, and Amazon—may exacerbate challenges faced by the current international tax system. Digitalization raises new questions, such as how commercially valuable information generated by users of online services should affect taxing rights of countries. Should aspects of destination—that is, where the final consumers reside—play a more prominent role in assigning taxing rights? Efforts to modify the international tax framework should preferably be coordinated and consistent with a long-term vision for the international tax architecture.

Governments will need to mitigate new digital risks. Digital interactions with governments may impose a disproportionate burden on small businesses and vulnerable households with limited access to technology. Digitalization itself also creates new opportunities for fraud and disruption of government functions. This includes the use of digital means to evade taxes or illegally claim benefits. Massive data breaches and intrusions of privacy have increased, highlighting the vulnerabilities of public digital systems.

Digitalization is not a panacea. It calls for a proactive, forward-looking, and comprehensive reform agenda. Governments must address multiple political, social, and institutional weakness and manage digital risks. They must also budget adequate resources to finance investments in digital infrastructure and cybersecurity. Last but not least, digitalization makes international cooperation even more necessary.

But digitalization is already an overwhelming trend. It is likely to accelerate further. Governments can try to resist it and adapt late and reluctantly; or they can embrace it, foresee it, and even, to some extent, shape it.