EXECUTIVE SUMMARY

This chapter provides an outline for policymakers to reinvigorate economic growth and counter adverse macroeconomic shocks with a framework called IDEAS: *I*nvest for the future—in health systems, infrastructure, low-carbon technologies, education, and research—thereby boosting productivity growth; adopt well-planned *D*iscretionary policies; and *E*nhance *A*utomatic *S*tabilizers, including features of the tax and benefit system that stabilize incomes and consumption, such as progressive taxation and unemployment assistance. This framework can inform policies to respond to downturns or weak demand. At the current juncture, governments are actively enhancing the automatic stabilizers by expanding social safety nets to support people during the COVID-19 pandemic. But it is also important to prepare investment plans and discretionary policies more generally, to be deployed as shutdowns end and fiscal stimulus becomes effective and, depending on fiscal space, appropriate.

Low interest rates present an opportunity for high-return public investment—a priority in most countries. Over the past decade, a moderation of capital accumulation has slowed economic growth. Modernizing the aging infrastructure in *advanced economies* and addressing infrastructure needs and other sustainable development goals in *emerging market and developing economies* are important. In all countries, combating climate change requires investment in mitigation and adaptation. These additional investment needs are likely to exceed $20 trillion globally at current prices, over the next two decades.

For *advanced economies* with fiscal space, undertaking more investment projects is worthwhile because the value of the resulting assets will likely exceed the liabilities incurred, thus improving the public sector's net worth. Where fiscal space is limited, it is appropriate to reorient revenues and expenditures to increase investment in health systems, infrastructure, and people. In *emerging market and developing economies*, high debt levels and rising interest expenditures call for financing development in a fiscally responsible way. In *low-income developing countries*, raising tax revenues would be crucial over the long term. Improving investment management is critical for all countries: one-third of funds for public infrastructure is lost worldwide to inefficiencies.

Discretionary fiscal support during previous downturns often came too late and was not well targeted. To reduce implementation lags and guide expectations, policymakers should act swiftly to establish a pipeline of appraised investment projects now that can be implemented when the health crisis abates, and plan discretionary measures that can be deployed quickly.

Enhancing automatic stabilizers, especially improving unemployment benefit systems and social safety nets, can protect household incomes from adverse shocks and strengthen resilience against epidemics. For example, if *Estonia* or the *United States* were to upgrade their benefit systems to the median level of Organisation of Economic Co-operation and Development countries, net incomes of workers who lose their jobs during recessions would fall by one-third less. Timely extension of the coverage and benefits of social safety nets (a priority during the pandemic) would support the consumption of vulnerable households. A good example is a guaranteed minimum income scheme that is selective, conditional, and means tested. While many countries are providing greater social assistance to households to fight COVID-19, a premium should be placed on measures that improve tax-benefit systems permanently.

Introduction

Low growth and investment, adverse shocks, and low inflation and interest rates during the past few years put fiscal policy at the forefront. The COVID-19 pandemic of 2020 has strengthened the case for fiscal policy action and heightened its urgency. In the past few years, growth has been subdued in advanced economies, reflecting various factors including a moderation in capital accumulation (Box 2.1). Sustained high and inclusive growth is critically needed for development in emerging market and developing economies. Inflation has trended down since the 1980s and is currently below targets in two-thirds of inflation-targeting countries. In advanced economies, inflation expectations are anchored at low levels. Nominal interest rates are at historical lows, shifting the balance of cyclical demand support toward fiscal policy. This is because the natural rate of interest—the interest rate that keeps the economy at full employment with stable inflation—is estimated to have fallen significantly and is now below zero in some economies (Rachel and Summers 2019). Consequently, the effective lower bound on policy rates binds more frequently. Moreover, the nominal interest rate on new government borrowing, although at times volatile, is currently negative in many advanced economies (something historically unprecedented). These patterns have been exacerbated by the COVID-19 pandemic (Chapter 1), resulting in a global recession this year, and are likely to persist during the post-shutdown recovery.

This chapter explores how fiscal policies can respond to weak growth with IDEAS: (1) Investing for the future in infrastructure, low-carbon technologies, health care, education, and research; (2) enacting Discretionary measures that can be deployed contingent upon a particular state of the economy (Chapter 2 of the April 2020 *World Economic Outlook*); and (3) Enhancing Automatic Stabilizers—particularly by improving unemployment benefits and social safety nets—that are key fiscal tools being used by countries in response to the pandemic. In discussing the IDEAS approach, the chapter will emphasize maximizing the benefits from sustainable, resilient public investment and improving social safety nets (that is, noncontributory transfer programs financed by general government revenue) (Figure 2.1).

Low-for-long interest rates present an opportunity for quality public investment across the world to boost growth. Discretionary fiscal policies can have larger fiscal multipliers when policy rates are at the effective lower bounds and economic slack and fiscal space exist, because the policies can lead to a virtuous cycle that spurs private consumption and investment through higher inflation expectations and lower real interest rates (Christiano, Eichenbaum, and Rebelo 2011; Eggertsson 2011; Woodford 2011; Auerbach and Gorodnichenko 2012, 2013; Correia and others 2013; Farhi and Werning 2016). With significant supply disruptions, the size of fiscal multipliers is more uncertain during pandemics and before the recovery phase. High levels of public debt, however, remain a vulnerability and impose constraints on the use of countercyclical fiscal policies in downturns (Romer and Romer 2019; April 2018 *Fiscal Monitor*). Moreover, when public debt is high, the multiplier effects of discretionary fiscal policies are lower (Bi, Shen, and Yang 2016). At high debt levels, automatic stabilizers can still be effective at reducing macroeconomic fluctuations. To that end, strengthening social safety nets can be highly effective, so it is an urgent priority to tailor the safety nets to the special situation of the pandemic.[1]

[1]The merits of improving tax-benefit systems go well beyond stabilization. Reducing tax distortions and providing incentives to encourage labor supply and investment, along with well-designed benefit systems, could contribute to supply potential and long-term growth. A strong safety net and unemployment insurance can reduce inequality and the need for precautionary savings (underlying causes of prolonged demand weaknesses), particularly for emerging market and developing economies (Di Maggio and Kermani 2016; Hsu, Matsa, and Melzer 2018). At the same time, if the burden of structural reforms and the cost of deleveraging fall on low-income households and small businesses, a well-designed safety net can alleviate such costs.