

The New Mediocre in Asia: What Can Fiscal Policy Do?

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The New Mediocre in Asia

- Rapid population aging and weaker productivity are important challenges to sustained, inclusive growth
- These features vary across Asia:
 - **Group 1** (Japan): stagnation for over two decades, well before other advanced economies
 - **Group 2** (China, Hong Kong SAR, Korea, Singapore, and Thailand): rapid aging; slowdown in productivity
 - **Group 3** (India, Indonesia, Malaysia, the Philippines, Vietnam, and other): affected through spillovers

Today's talk: The New Mediocre and Fiscal Policy in Asia

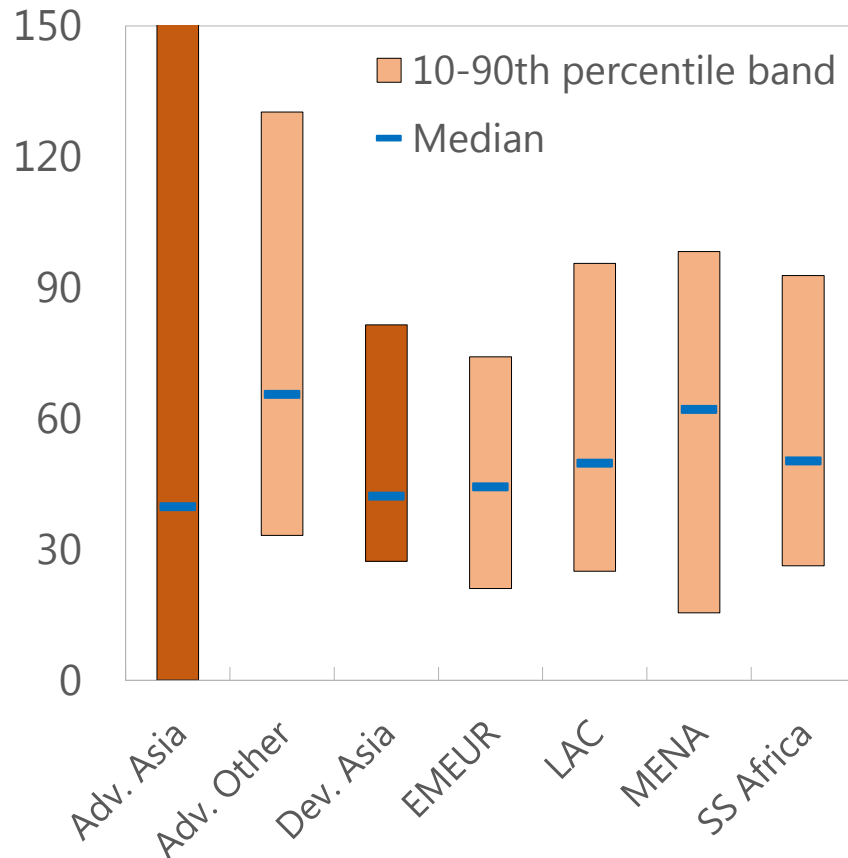
- 1) Left unchecked, age-related spending poses a threat to long-term fiscal sustainability
- 2) Even budget-neutral fiscal measures can boost sustained, inclusive growth
- 3) Dividends can double under debt financing in a low-inflation environment
- 4) Strong policy frameworks and structural reforms are critical to address the new mediocre

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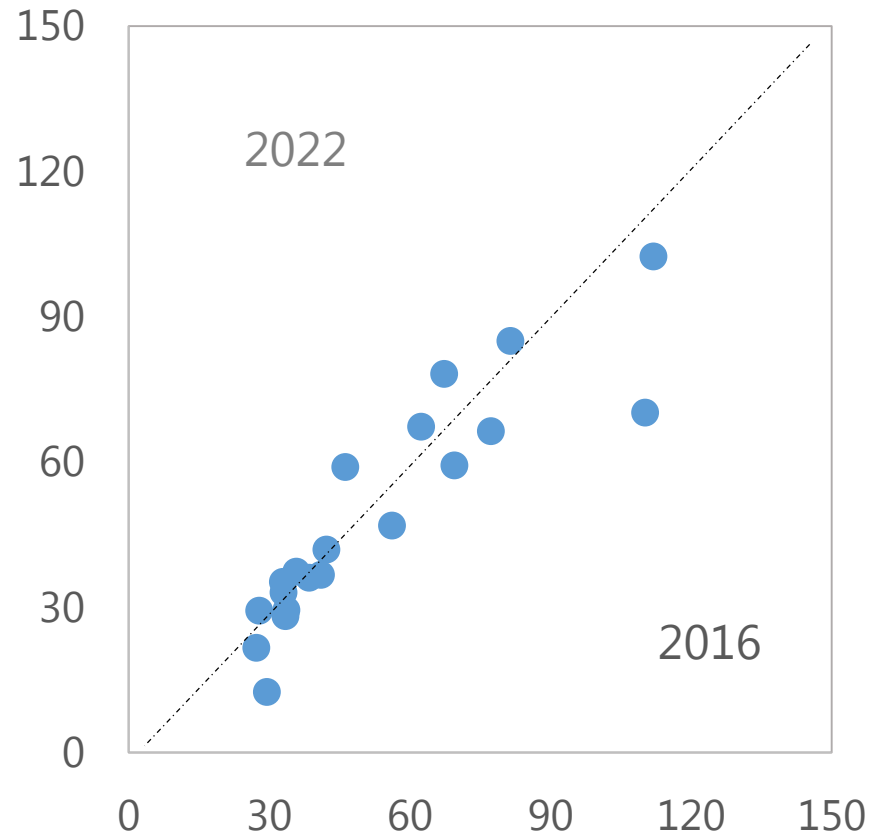
- 1) Left unchecked, age-related spending poses a threat to long-term fiscal sustainability

Public debt is projected to remain low in the near term...

Public Debt in Asia and Other Regions, 2016
(In percent of GDP)

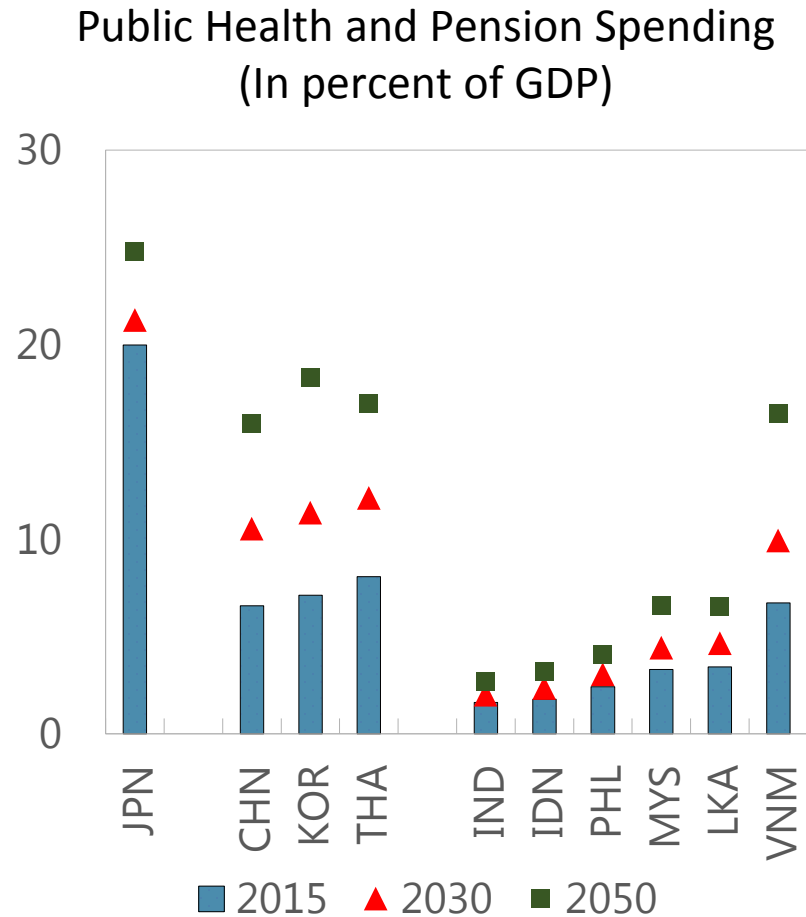


Public Debt in Asia, 2016 vs. 2022
(In percent of GDP)

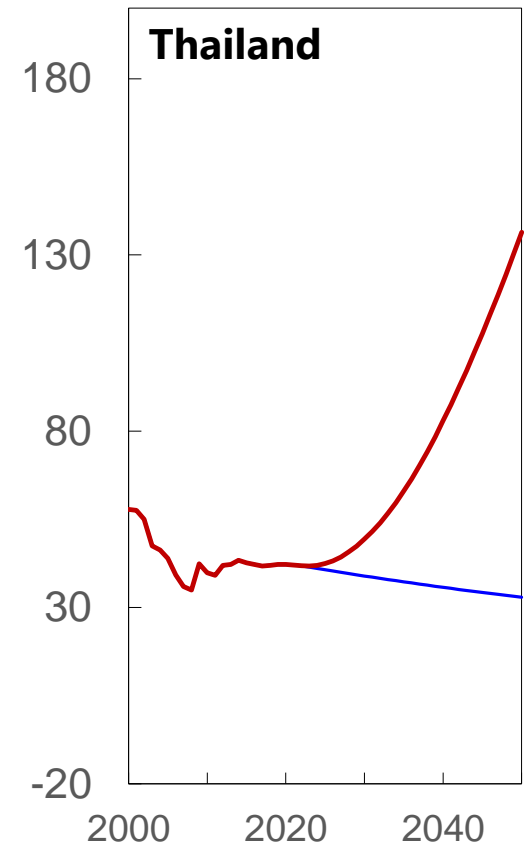
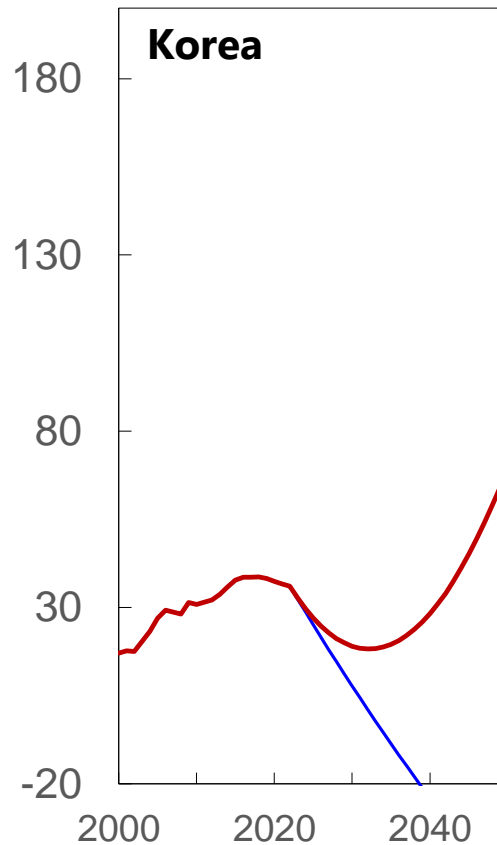
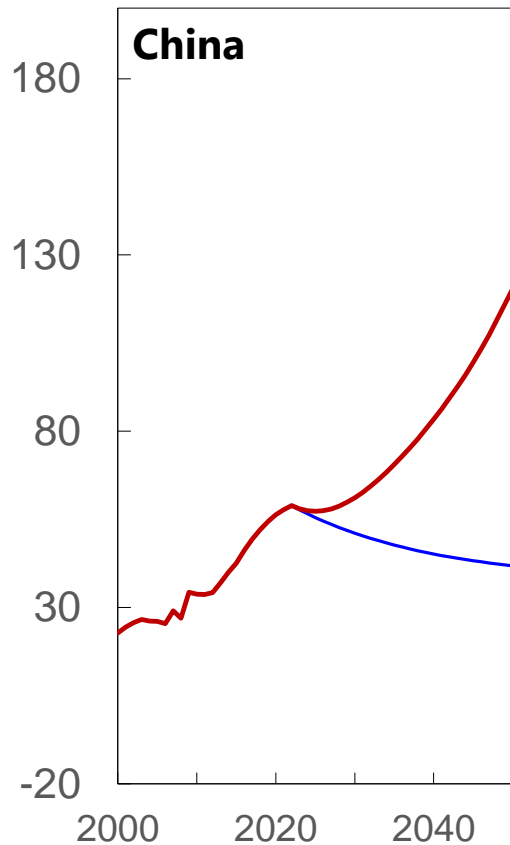


...but public health and pension spending is set to rise in Group 2

- These projections assume constant coverage and benefit ratios—the increase in spending is driven only by changes in the old-dependency ratio
- Aging will also lower labor force participation and potential growth



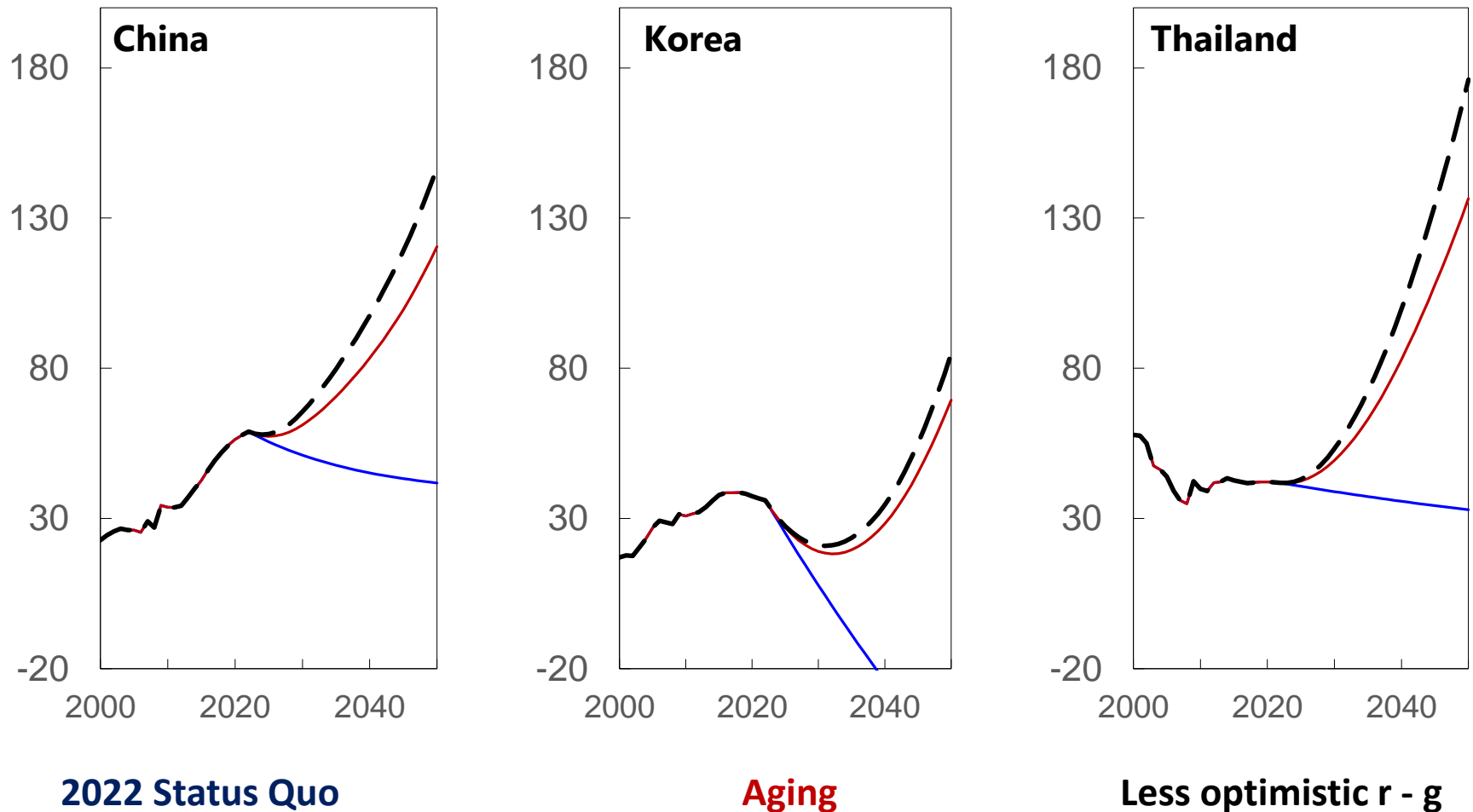
Left unchecked, age-related spending poses a threat to long-term sustainability



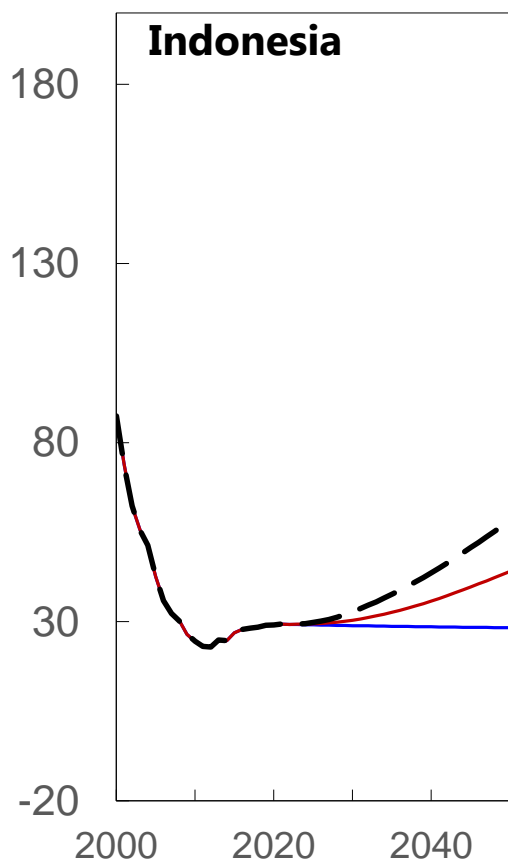
2022 Status Quo

Aging

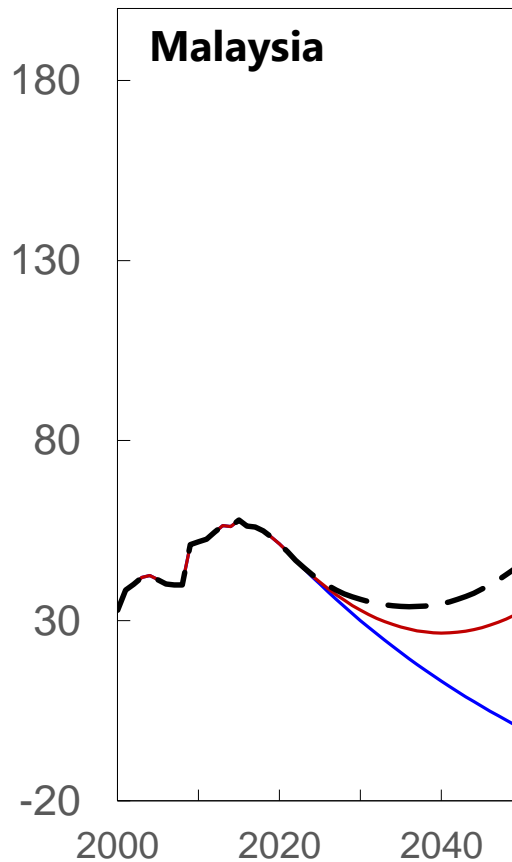
A less favorable interest rate-growth differential adds further risk



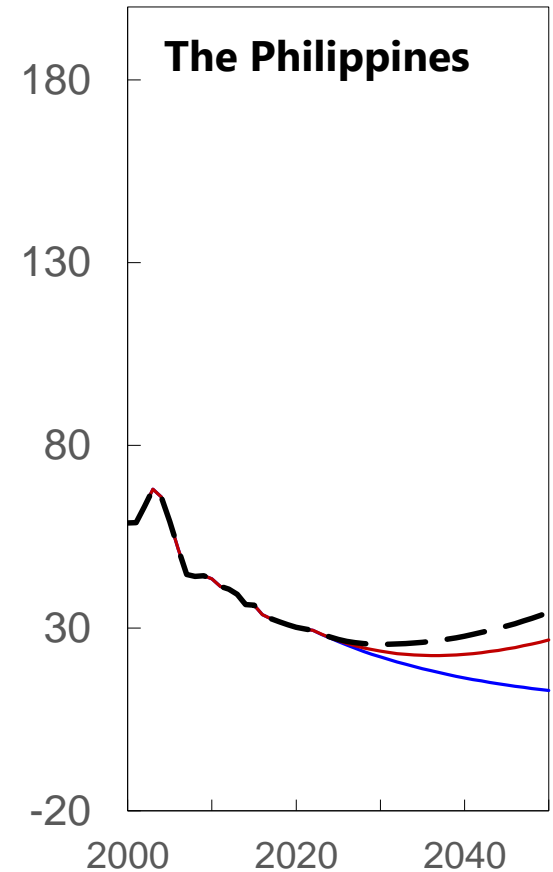
Younger economies in Group 3 face significantly lower risks



2022 Status Quo



Aging



Less optimistic r - g

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- 2) Even budget-neutral fiscal measures can boost sustained, inclusive growth

Fiscal policy can support sustained, inclusive growth

- Target spending and taxes with high long-term multipliers
Increase infrastructure, education, healthcare, R&D
- Strengthen efficiency
Cut unproductive spending; broaden indirect taxes and tax bases
- Address inequality
Strengthen redistribution; promote access
- Mitigate demographic pressures
Encourage LFP of women; improve quality of labor force

Maintain macroeconomic stability

A model illustration for Asia

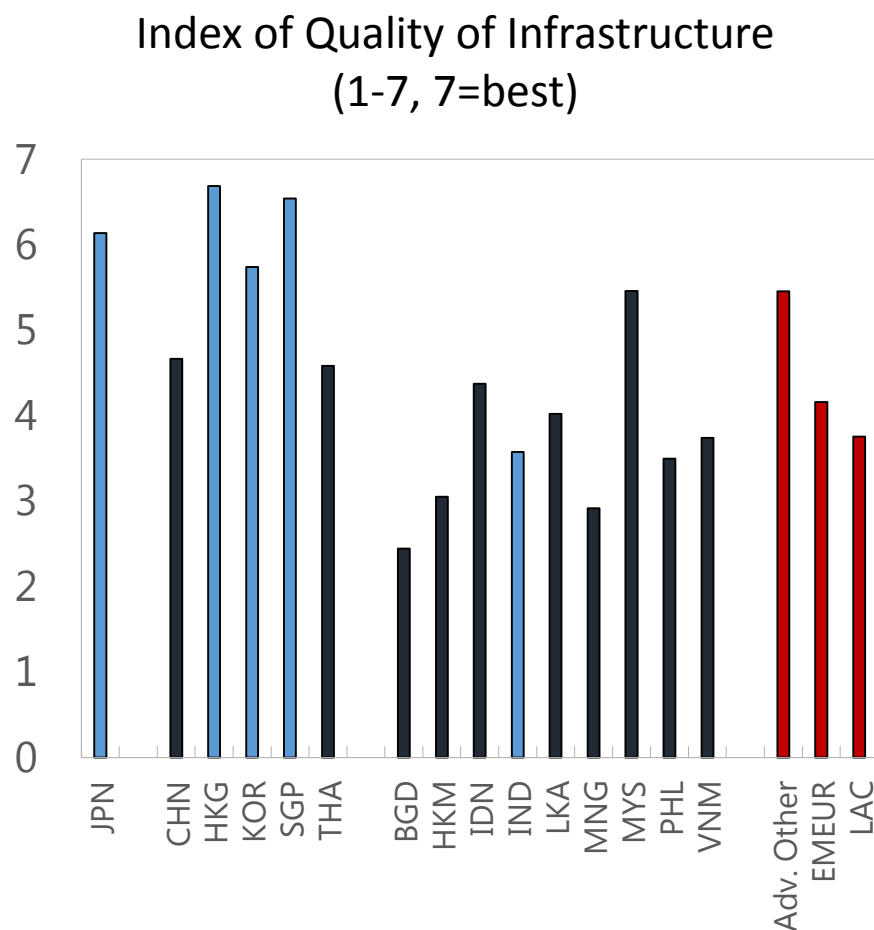
- Asia Module of the Flexible System of Global Models
 - 16 countries for Asia; 8 blocks for the RoW
- Households (liquidity-constrained, saving); firms
- Fiscal policy plays a key role in the economy
 - Infrastructure investment
 - Transfers (general and targeted)
 - Taxes (VAT, PIT, CIT)
- Monetary policy generally follows inflation targeting

Three packages of fiscal measures

- Infrastructure push
- Tax rebalancing
- Labor markets

Three packages of fiscal measures

- Infrastructure push
 - Dev. countries Group 2-3
 - 1 % GDP for 5 years
 - Financed by lower transfers
- Tax rebalancing
- Labor markets



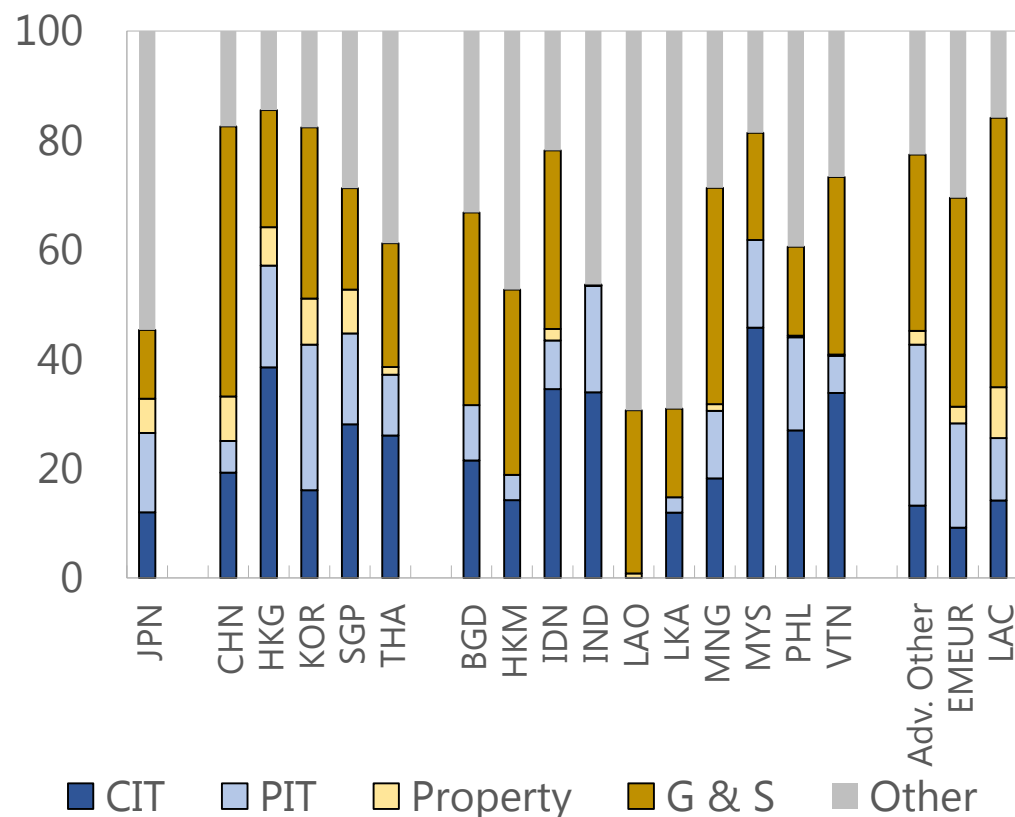
Three packages of fiscal measures

- Infrastructure push

- Tax rebalancing
 - Increase in VAT
 - Cut in PIT and CIT
 - Progressive design

- Labor markets

Composition of Tax Revenues
(In percent of total revenue)



Three packages of fiscal measures

- Infrastructure push

- Tax rebalancing

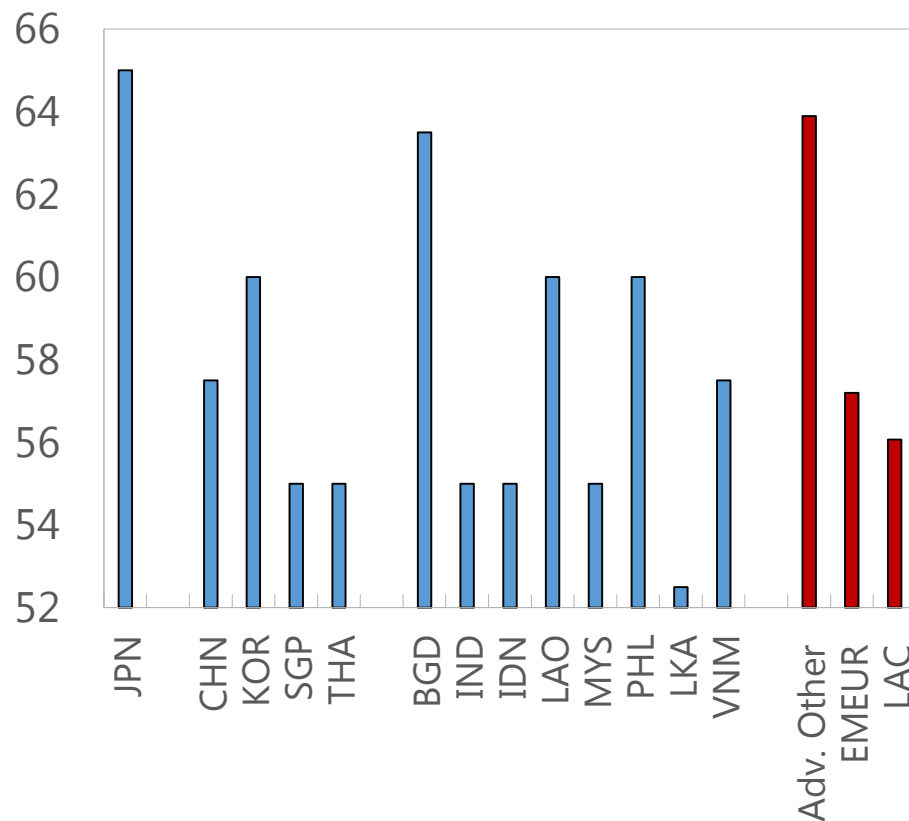
- Labor markets

↑ Retirement age

↑ Childcare and ALMP

↑ Revenue as needed

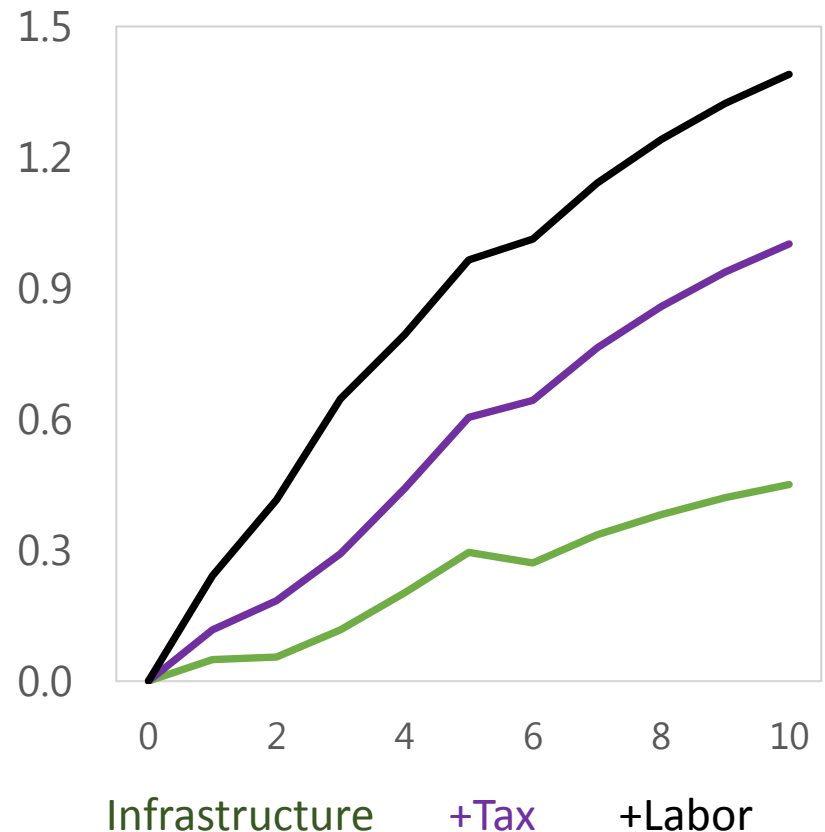
Average Retirement Age
(In years)



Baseline: Budget-neutral packages

- Asia's real GDP increases by 1.5 pps in a decade; can be scaled up
- Group 2 benefits the most. Real GDP increases by 2.5 pps in a decade; growth up by 0.3 percent first 5 years
- The three packages contribute roughly the same in the long term

All of Asia: Real GDP
(Percentage Points Difference)



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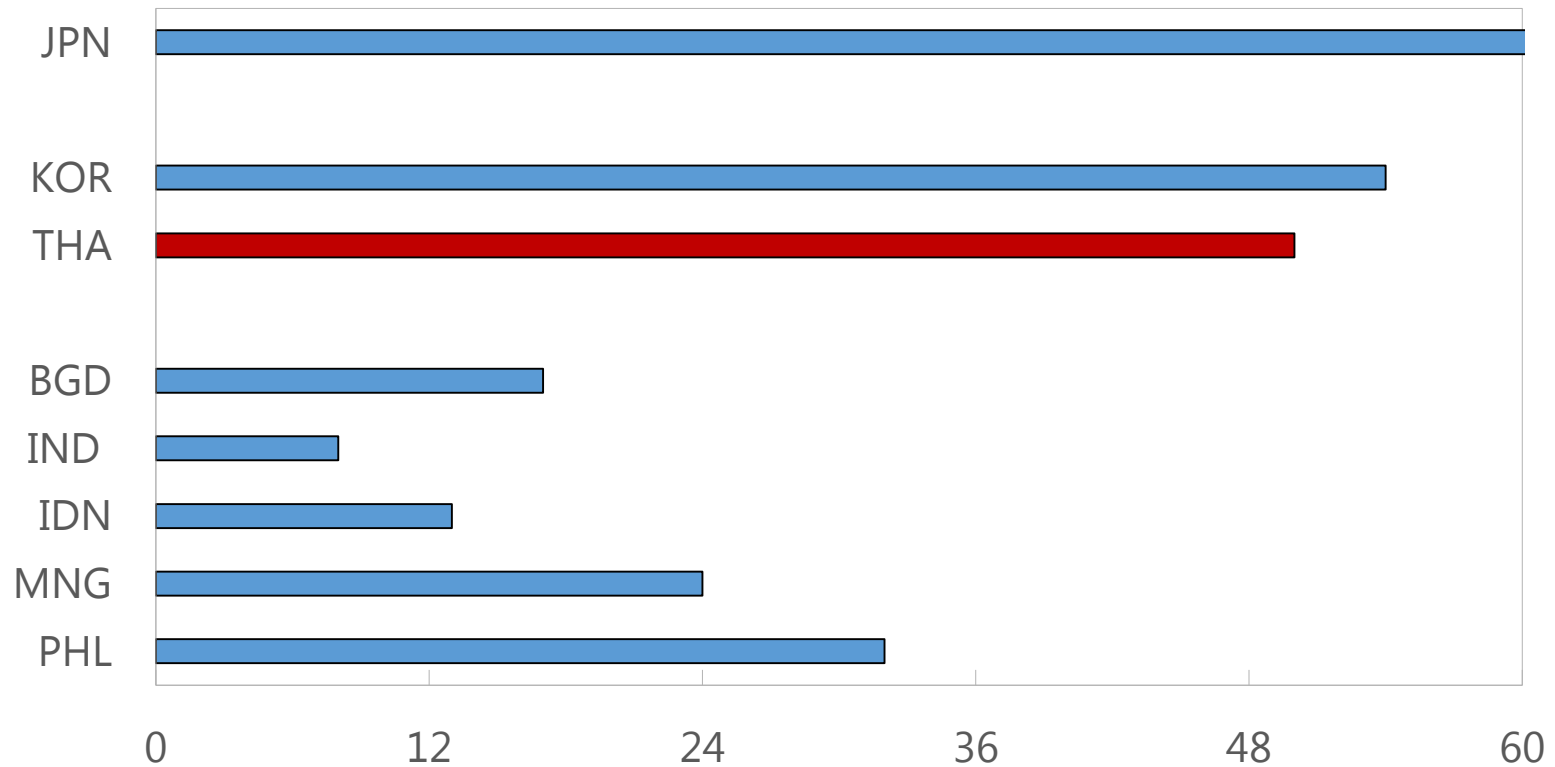
Achieving higher growth dividends

Alternative simulations show the benefits of:

- Progressive tax and spending changes
- Improvement in public investment efficiency
- Positive spillovers from regional coordination
- Infrastructure push in a low-inflation environment

A feature of the New Mediocre has been low inflation in many countries

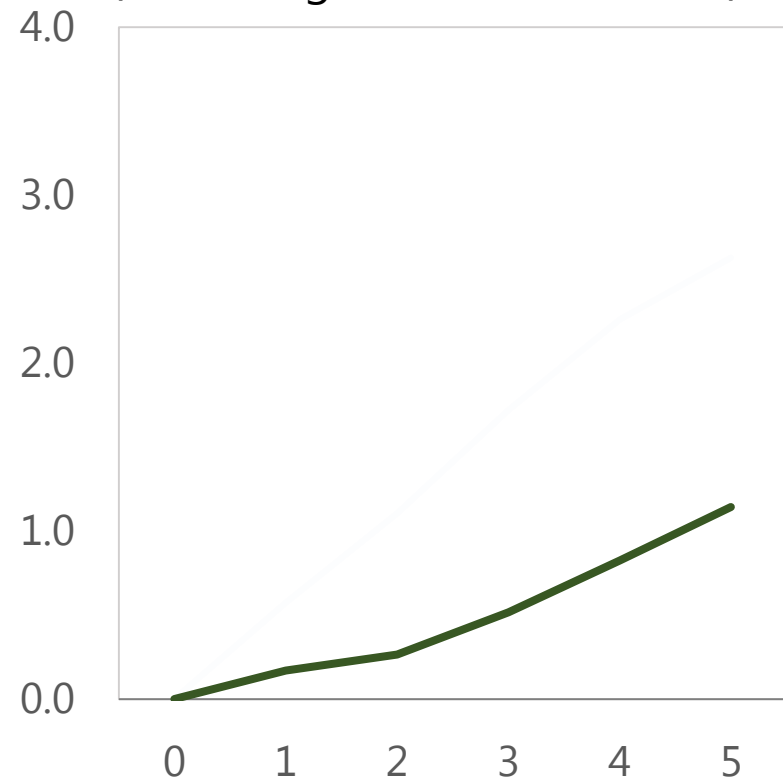
Months of Inflation Below Target, 2012-17



Thailand: Monetary accommodation of debt financed infrastructure

- In the **baseline**, monetary policy reacts to the infrastructure push, crowding out of private demand

Thailand: Real GDP
(Percentage Points Difference)

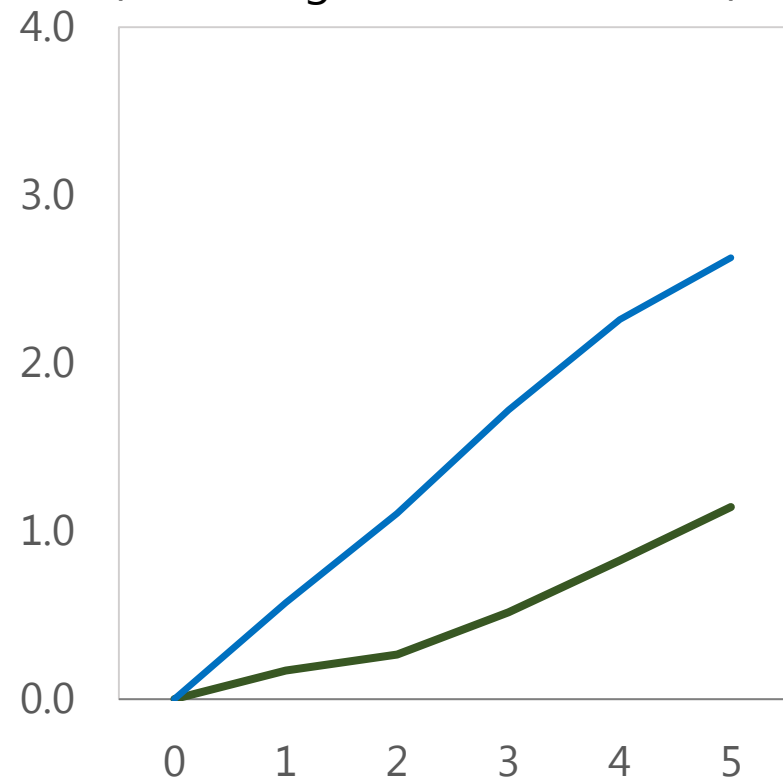


Lower transfers without monetary accommodation

Thailand: Monetary accommodation of debt financed infrastructure

- In the baseline, monetary policy reacts to the infrastructure push, crowding out of private demand
- With monetary accommodation, a flat interest rate encourages investment/discourages saving

Thailand: Real GDP
(Percentage Points Difference)



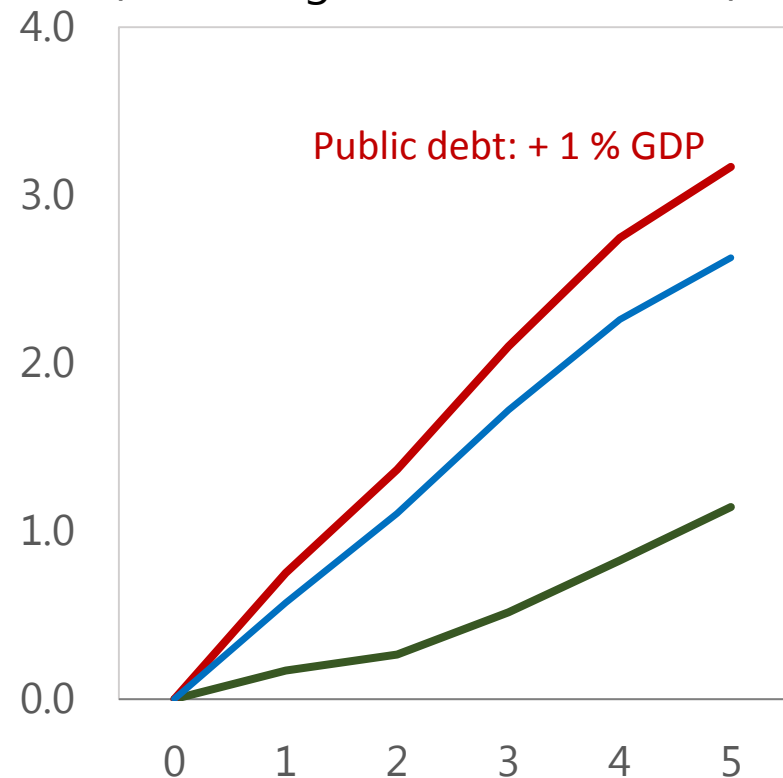
Lower transfers without monetary accommodation

Lower transfers with monetary accommodation

Thailand: Monetary accommodation of debt financed infrastructure

- In the baseline, monetary policy reacts to the infrastructure push, crowding out private demand
- With monetary accommodation, a flat interest rate encourages investment/discourages saving
- With monetary accommodation and debt financing, GDP (and consumption) increase further

Thailand: Real GDP
(Percentage Points Difference)



Lower transfers without monetary accommodation Lower transfers with monetary accommodation
Debt with monetary accommodation

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To reap higher growth dividends, critical elements must be in place

- Simulation results hold if risk premium is contained
- More broadly, critical elements are:

Quality measures that address country-specific gaps

Credible fiscal anchors that consider the new mediocre

Inclusive and sustainable Social Security Reform

- Structural reforms in healthcare
- Automatic adjustment mechanisms in pension systems
- Better coverage and benefits—revenue mobilization

The 1-slide presentation

Left unchecked, age-related spending poses a threat to long-term fiscal sustainability	Public debt in some fast aging countries could exceed 130 percent of GDP in two decades
Even budget-neutral fiscal measures can support sustained, inclusive growth	Infrastructure, tax rebalancing, and labor reforms could raise growth by 0.3 percent...at zero cost
Dividends can double under debt financing in a low-inflation environment	Monetary accommodation crowds in private demand if risk premia remain contained
Strong policy frameworks and structural reforms are critical to address the new mediocre	Quality measures Credible fiscal anchors Inclusive, sustainable safety nets

