

On the Long-Term Impact of a Fiscal Devaluation: An Application to the Portuguese Case

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Chapter 6 in C. Amo-Yartley (Ed.), 2015, Fiscal Policies:
International Aspects, Short and Long-Term Challenges and
Macroeconomic Effects, Nova Publishers

Outline

1. Motivation
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3. A sketch of the model
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5. What is the tax wedge on labor?
6. The reason why a fiscal devaluation disappoints
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1. Motivation

Europe is falling behind the US (see Eurogroup 2014)



Ongoing research project - see Pereira e Rodrigues (2014) "[O papel da reforma fiscal numa estratégia de consolidação orçamental sustentável em Portugal](#)" in Mendes e Cabral (Eds.), *Por Onde Vai o Estado Social em Portugal?*, pp. 23-65.

2. The research questions

How will a “fiscal devaluation” affect the level of GDP and the ratio of public debt to GDP in Portugal in the long run?

How sensitive is the impact to a “cost of living adjustment” (COLA)?

How big should a fiscal devaluation be, and are there scale effects?

What is a “fiscal devaluation”?

A budget-neutral swap from an origin tax to a destination tax.

Why the policy interest in replacing FSSC with VAT?

Currency union (Keynes 1931), unemployment (90s), peripheral EU countries (PIGS) arguably need to regain competitiveness.

3. A sketch of the model

Dynamic general equilibrium ([DGEP](#))

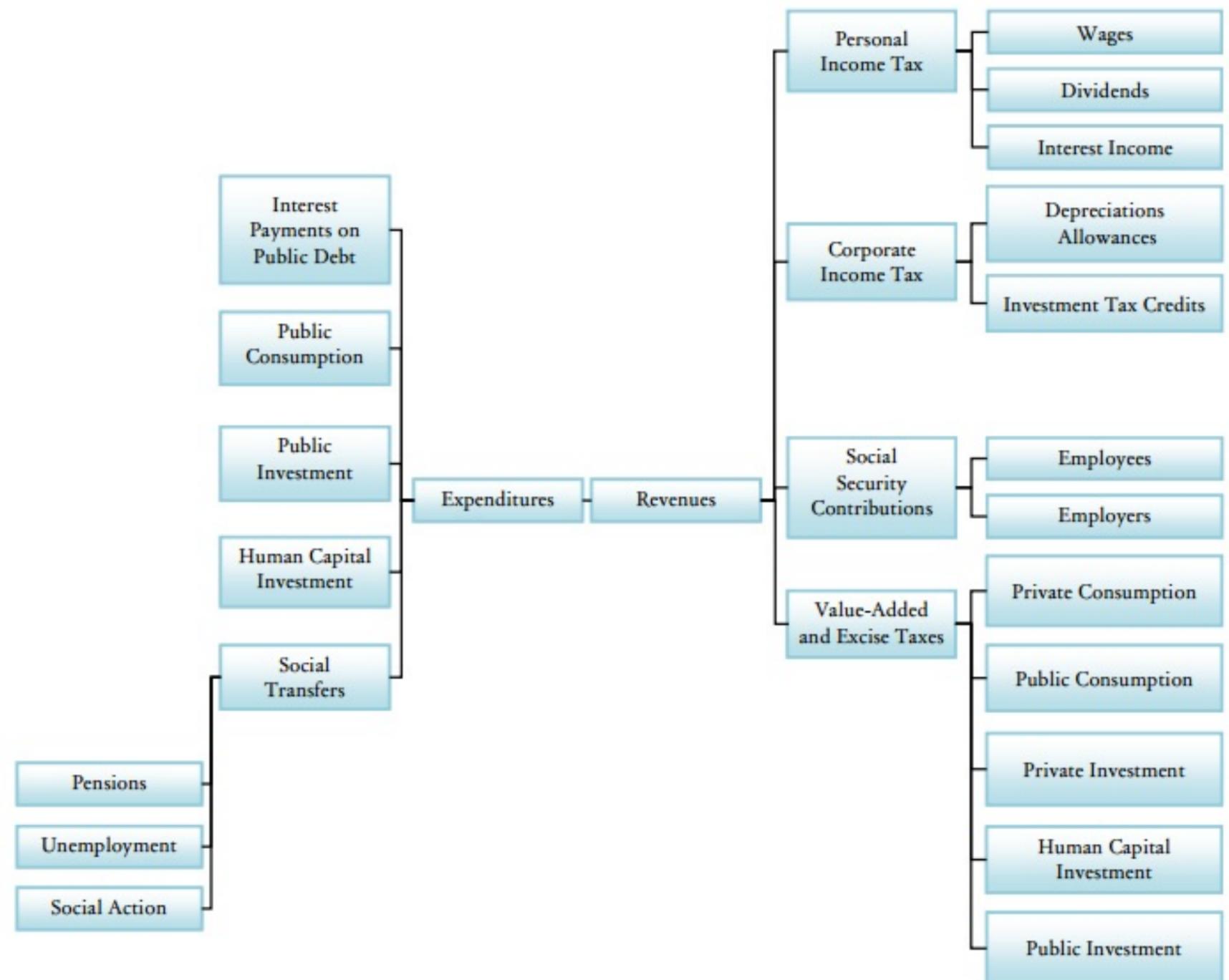
* Households

* Firms

* Public sector

* Rest of the world

Feedback



4. Simulation results

	Case 1 (No COLA)	Case 2 (Full COLA)
Δ VAT (p.p.)	3.47	3.47
COLA (%)	0.00	1.41
Δ FSSC (p.p.)	-6.05	-4.25
GDP = Y (%)	1.03	0.71
Employment (%)	0.37	0.11
Consumption wage (%)	0.75	0.18
Consumption (%)	0.70	0.42
Investment (%)	1.34	0.98
Public debt / Y (p.p.)	-4.27	0.41
Foreign debt / Y (p.p.)	5.56	5.08

4. Simulation results

Diminishing returns quickly set in. Bigger is not better.

Impulse (as % of SS GDP)	1	2 = DE	5
GDP (% change)	1.03	1.99	4.56

How do our results compare with the literature?

Pereira, Pereira and Rodrigues (2015)	Banco de Portugal (2011)	European Central Bank (2011)	European Commission (2011)
0.71 - 1.03	0.6	0.3	0.2 - 0.5

5. What is the tax wedge on labor?

Country/Region	Overall tax wedge on labor
United States	34.23
EU15 (2013 GDP weights at PPP exchange rates)	53.07
Austria	58.04
Belgium	63.50
Denmark	52.79
Finland	54.98
France	57.35
Germany	57.68
Greece	49.74
Ireland	39.79
Italy	55.65
Luxembourg	51.12
Netherlands	49.32
Portugal	50.13
Spain	47.98
Sweden	54.86
United Kingdom	42.44

6. The reason why a fiscal devaluation disappoints

$$1 - \frac{w(1 - \tau_{PIT} - \tau_{WSSC}) / (1 + \tau_{VATET,C})}{w(1 + \tau_{FSSC})}$$

	Case 1 (No COLA)	Case 2 (Full COLA)
Labor tax wedge (p.p. change)	-0.27	0.02
Employment (% change)	0.37	0.11

7. What's next?

	Exogenous growth	Endogenous growth
With fiscal consolidation (debt/GDP falling)	Done	✓
Extra resources for further fiscal devaluation (const. debt/GDP)	✓	✓

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Que seca ...

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Austeridade, em grego, quer dizer “secura de boca”.

Como todos, tenho acompanhado as viagens e as declarações do Primeiro-Ministro e do Ministro das Finanças da Grécia, assim como as reacções dos responsáveis máximos da chamada Troika.

Hoje decidi fazer umas contas para determinar se mais austeridade é ou não inevitável na Grécia. Os resultados a que cheguei não são animadores ...

Em vez de analisar o que se passa com o país – confesso que tantos zeros deixam-me com

Nuvem de palavras

Alemanha Ausgang
Austeridade Bancos BCE
Chicago China
Competitividade
Comércio Comércio internacional
conferências Crescimento
Crescimento
económico Crescimento
económico equilibrado Crise Crise
de dívida soberana
Crowding-out crude
Desemprego Desperdício

My coordinates

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