LONG-TERM FISCAL FORECASTS: OECD Approach

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BETTER POLICIES FOR BETTER LIVES

Outline

- OECD long-term projections:
  - comparative perspective
  - global consistency
  - this comes at some cost

- Three aspects of OECD framework:
  1. Economic projections
  2. Fiscal projections
  3. Health + long-term care projections

Old approach (Beffy *et al.*)

- Medium-Term Baseline (MTB) model
  - production function approach
  - HP filter based on ST projections
  - population growth based on UN
  - actual investment rates, PIM capital stock

(1) BLT – Baseline Long Term model

- Conditional convergence framework
  - C-B constant returns production function
  - conditional TFP convergence
  - structural/policy determine end point
  - policies converge towards best practice
- "Catch up" growth
- Output gaps closed over 4 or 5 years

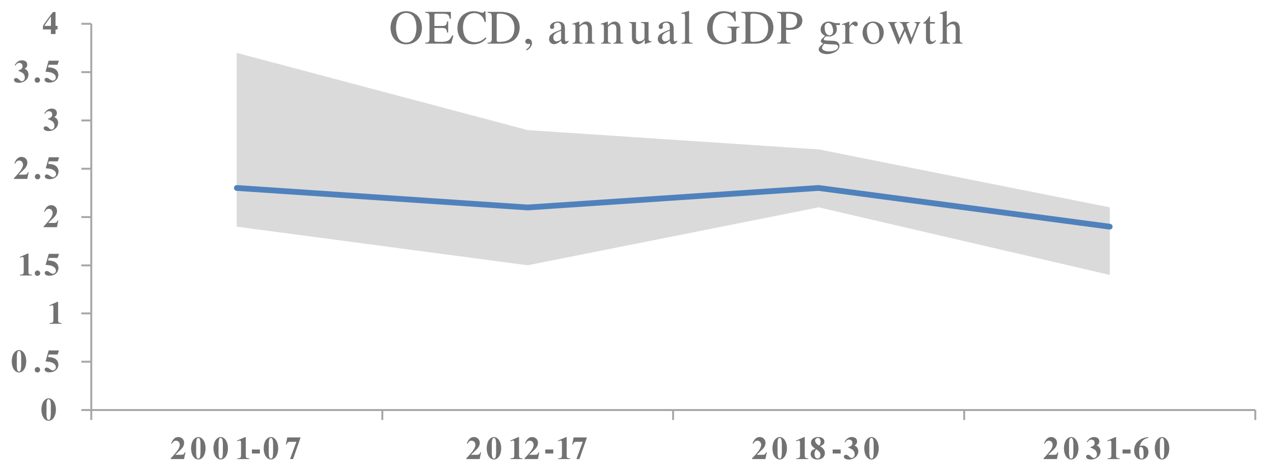
See Johansson et al (2013)

Savings & Investment

- Domestic factors
  - private savings rate (Kerdrain *et al* 2010)
    - old-age/youth dependency
    - {terms of trade, productivity, oil, credit}
  - fiscal policy – stabilisation of debt/GDP
    - 40% Ricardian offset to private saving
  - monetary policy rule

- L-R global interest rate
  - global current account balance set to zero
- Risk premium on government debt
  - 2bps/1pp debt over 75%; +2bps/1pp over 125%

Long-term projections



	Potential real GDP		Labour productivity		Employment	
	2012-17	**2018-30**	**2012-17**	**2018-30**	**2012-17**	**2018-30**
OECD	**2.1**	**2.3**	**1.3**	**1.7**	**0.8**	**0.6**
Non-OECD	**6.9**	**5.1**	**5.8**	**4.4**	**1**	**0.6**
World	**3.3**	**2.4**	**2.7**	**2.3**	**0.6**	**0.1**
USA	**2.1**	**2.4**	1.3	1.4	0.8	0.9
Euro Area	**1.5**	**1.8**	1.1	1.7	0.4	0
Japan	**0.9**	**1.3**	1.2	1.7	-0.3	-0.3
China	**8.9**	**5.5**	8.4	5.9	0.5	-0.3

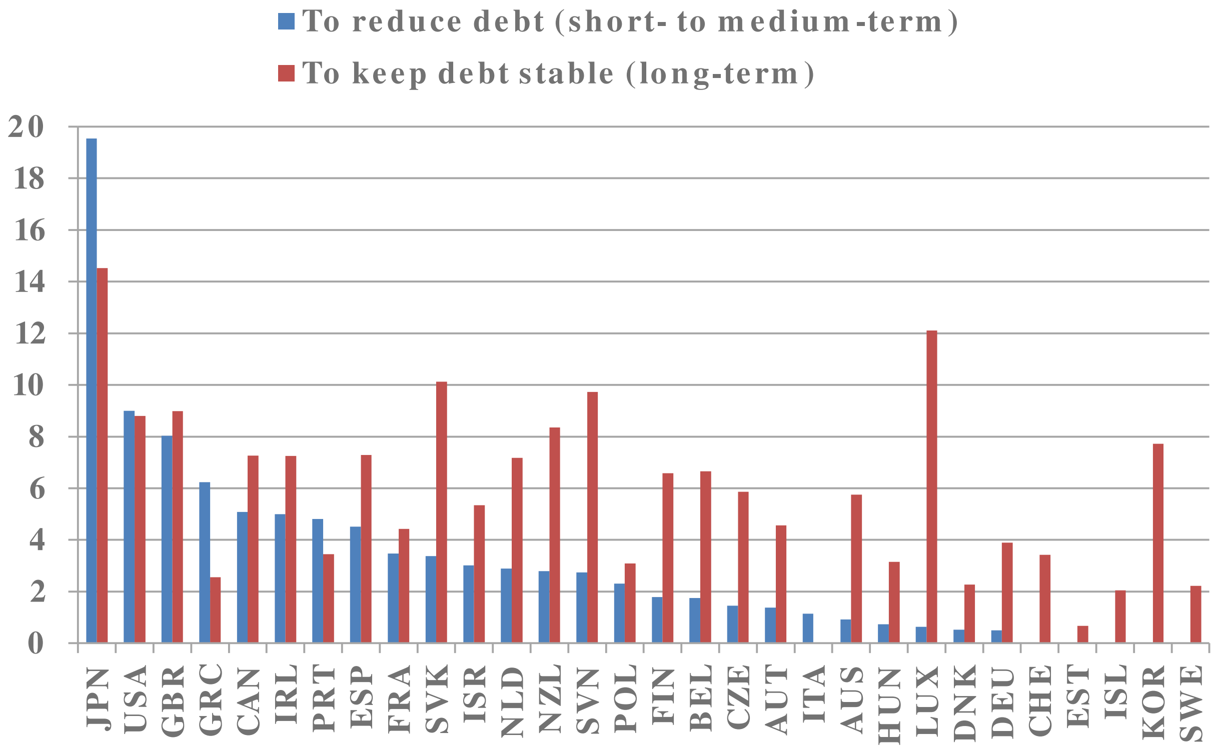
(2) Fiscal scenarios

- Stable 60% debt/GDP ratio by 2060
- Short-/medium- term consolidation need
  - 1pp changes in primary structural balance
  - *reach* 60% by 2060
- Long-term consolidation need
  - primary balance to *stabilise* debt at 60%

Long-term spending pressures

- Long-term consolidation accommodates underlying trend pressures
- Expected social pensions
  - current policy basis
- Health and long-term care
  - based cost containment scenario

Consolidation scenario

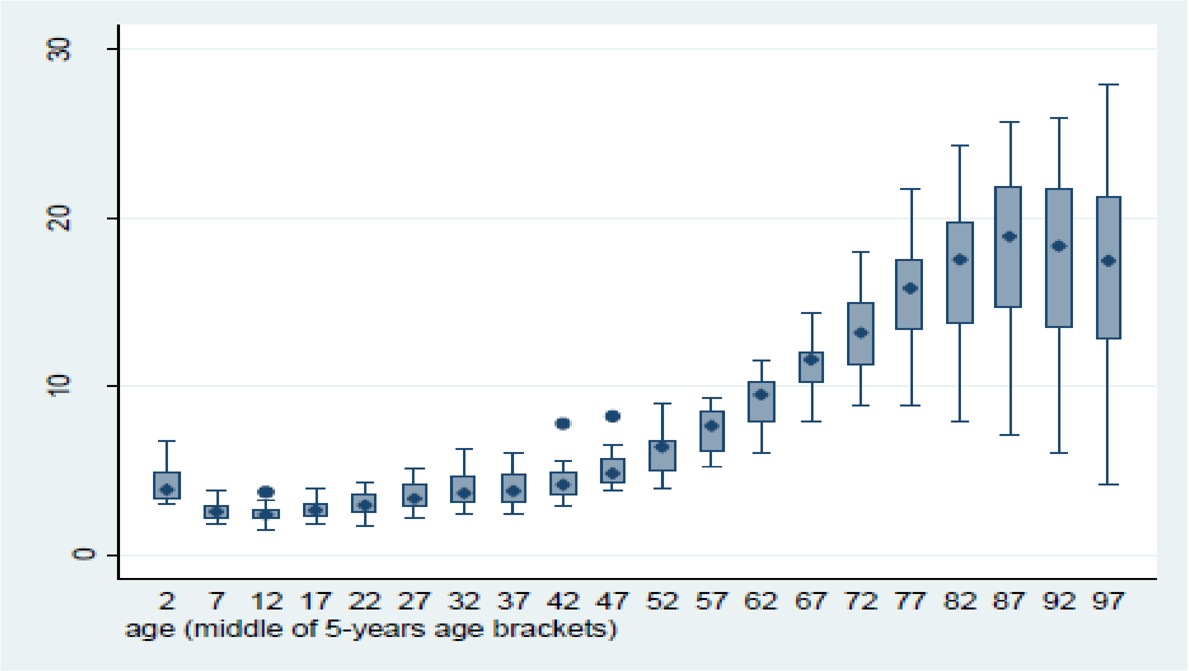


- Long-term needs typically dominate

(3) Health and long-term care

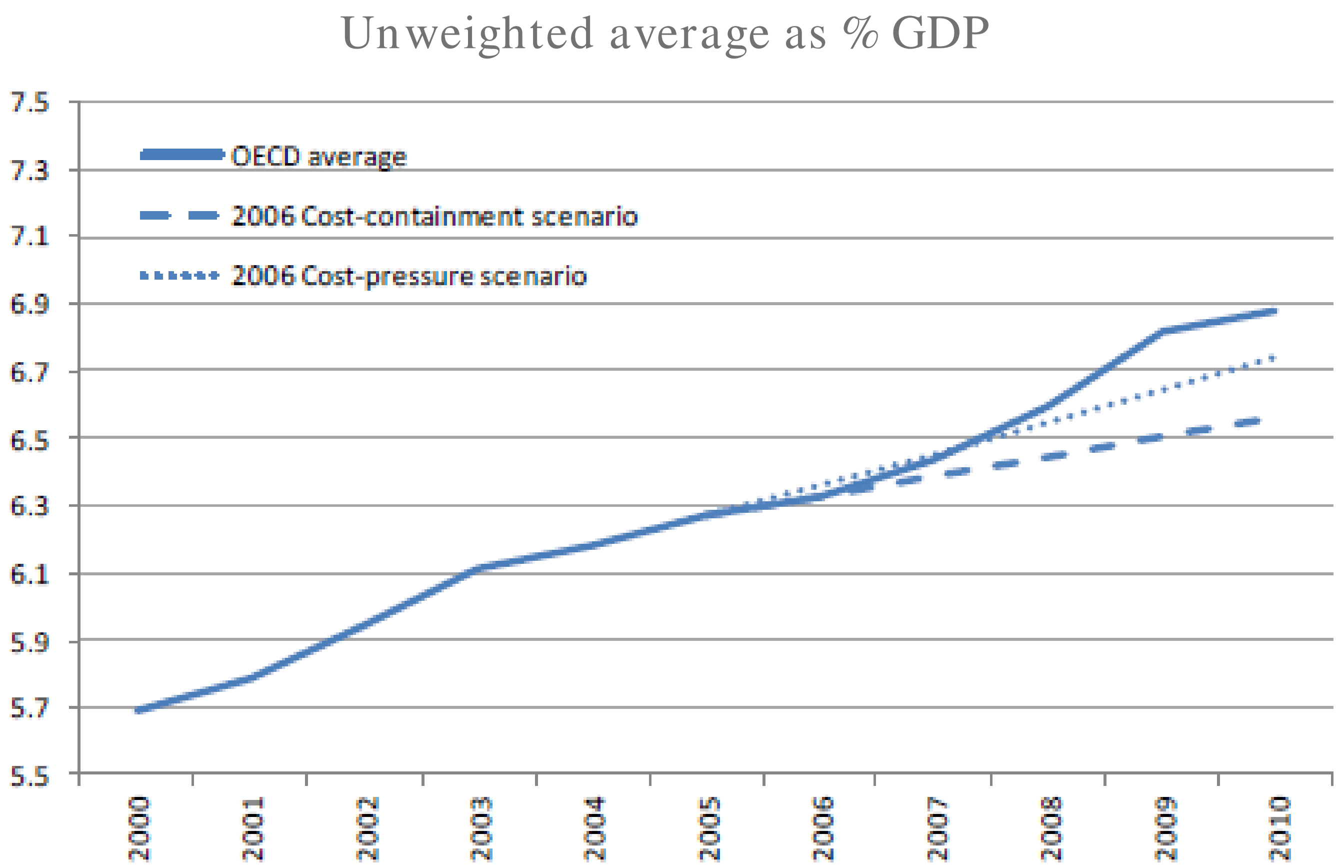
- Health care driven by technology, relative prices, institutions and policies
  - income elasticity of 0.8
  - significant residual
- Long-term care driven by weak productivity
- Around 6% of GDP in 2006-10
- 9.5% in 2060 in a ***cost containment scenario***
- 14% of GDP in a ***cost-pressure scenario***
  - no stepped-up policy action

Health spending is age related



- But demographics are not main driver
- 1995-2009 = 4.5% average y-o-y real growth
  - 1.7pp incomes, 0.5pp demographics

Rising health and long-term care costs



Scenarios for public health expenditure

- Wide variation in demographic effects
- Income effects more powerful for BRIICS

	Average 2006-2010	Percentage point deviations from starting period in 2030: Contributions of demographic and income effects: Demographic effect	Income effect	Total increase in spending ratio: Cost-pressure	Cost-containment
Australia	5.6	0.4	-0.4	2.0	1.5
Austria	6.6	0.4	-0.2	2.1	1.7
Belgium	5.8	0.2	-0.3	1.8	1.4
Canada	5.8	0.6	-0.3	2.2	1.8
Chile	3.1	0.9	-0.6	2.3	1.8
Czech Republic	5.5	0.4	-0.5	1.9	1.4
Denmark	6.3	0.4	-0.2	2.1	1.6
Estonia	4.3	0.2	-0.5	1.6	1.1
Finland	5.2	0.4	-0.3	2.0	1.5
France	7.4	0.3	-0.3	1.9	1.4
Germany	7.3	0.5	-0.3	2.1	1.6
Greece	5.4	0.3	-0.3	1.9	1.4
Hungary	4.8	0.2	-0.5	1.6	1.2
Iceland	5.8	0.3	-0.2	2.0	1.5
Israel	4.0	0.3	-0.2	2.0	1.5
Ireland	5.5	0.3	-0.2	2.1	1.6
Italy	6.1	0.3	-0.2	2.1	1.6
Japan	6.1	0.6	-0.3	2.3	1.8
Korea	3.3	1.1	-0.5	2.6	2.1
Luxembourg	4.4	0.4	-0.1	2.2	1.7
Mexico	2.5	0.6	-0.5	2.1	1.6
Netherlands	6.4	0.6	-0.3	2.2	1.8
New Zealand	6.4	0.5	-0.3	2.1	1.6
Norway	5.1	0.3	-0.4	1.9	1.4
Poland	4.1	0.4	-0.5	1.9	1.4
Portugal	6.5	0.4	-0.2	2.0	1.6
Slovak Republic	5.4	0.5	-0.5	1.9	1.5
Slovenia	5.2	0.5	-0.3	2.1	1.7
Spain	5.6	0.4	-0.3	2.0	1.6
Sweden	6.6	0.2	-0.3	1.8	1.3
Switzerland	5.7	0.4	-0.3	2.1	1.6
Turkey	3.8	0.7	-0.6	2.0	1.5
United Kingdom	6.5	0.2	-0.2	1.9	1.4
United States	7.1	0.4	-0.3	2.0	1.5
OECD average[1]	*5.5*	*0.4*	*-0.3*	*2.0*	*1.6*
Brazil	3.7	0.8	-0.6	2.1	1.6
China	1.9	0.9	-1.1	1.7	1.3
India	1.2	0.3	-1.0	1.3	0.8
Indonesia	1.2	0.6	-0.8	1.7	1.3
Russia	3.1	0.1	-0.6	1.5	1.0
South Africa	3.2	0.0	-0.6	1.4	0.9
Non-OECD average[1]	*2.4*	*0.5*	*-0.8*	*1.6*	*1.2*
Total average[1]	*5.0*	*0.4*	*-0.4*	*2.0*	*1.5*

References

Johansson et al (2013), "Long-term growth scenarios", OECD Economics WP100

Beffy et al (2006), New OECD methods for supply-side and medium-term assessments: a capital services approach , OECD Economics WP482

de la Maisonneuve et al (2013), “Public Spending on Health and Long-Term Care: A New Set of Projections”, mimeo