The Implications of Low Productivity Growth for Fiscal Policy

Karen Dynan
Nonresident Senior Fellow, PIIE
Professor of the Practice, Harvard University

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Why implications for fiscal policy?

Lower productivity growth matters for fiscal policy because it is associated with:

– Larger budget deficits
– Lower wage growth
– Lower interest rates
Larger budget deficits: Results from Sheiner

Lower productivity growth aggravates rise in US primary deficit

With effect on debt-to-GDP depending on how much interest rates fall

Data from Sheiner (2019)
Implications for fiscal policy (taking lower productivity growth as a given)

Larger budget deficits:

– Recent research (e.g. Blanchard, 2019) arguing debt has small costs given current low interest rates

– Still, D/GDP can’t rise infinitely—so lower productivity growth means **we will need to raise more tax revenue than we otherwise would** (discretionary spending already too squeezed to make big cuts)

– Also increases likelihood of cuts to income support and health care programs for older Americans, implying **more need for retirement savings incentives**
Implications for fiscal policy (taking lower productivity growth as a given)

Lower wage growth:

– Likely to lead to further declines in labor force participation for working-age Americans

– Heightens need for more fiscal incentives to work (e.g. expanded EITC, subsidies for child care)

Lower interest rates:

– Further limits scope for conventional monetary policy

– Given uncertain political will to use discretionary countercyclical fiscal policy, bolsters the case for putting more and better automatic stabilizers in place
Can we change fiscal policy in ways that boost productivity?

Truly pro-growth tax reform as well as investments in infrastructure, education, and research could make a material difference.

But, experience with 2017 Tax Act and lack of action on infrastructure suggest that making such changes is hard politically.

![Estimated Effect of 2017 Tax Act on 2017-2027 Annual GDP Growth Including Fiscal Stimulus Effects](image)

Note. Bars depict the range of estimates offered by these sources.