

PA974-001

Policy Responses to the  
Great Recession

Lecture 26 (12/10/09)

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Fall 2009

# Implications

- Slower potential output growth
- Lower capital intensity
- Higher NAIRU
- Debt spiral or fiscal consolidation?

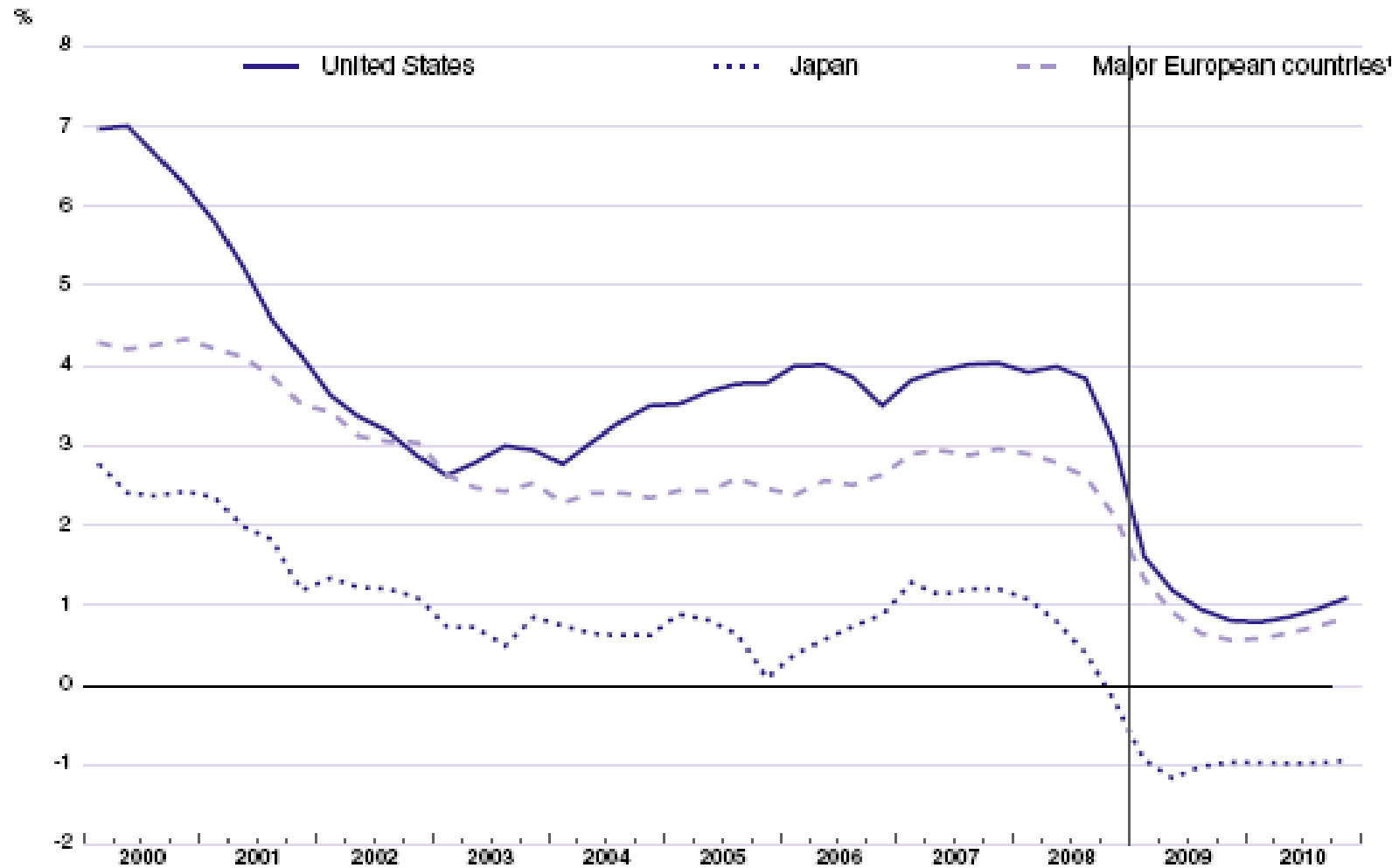
$$Y = F(N, K, A) = Af(N, K)$$

$$\Delta Y / Y = \Delta A / A + 0.7 \left[ \frac{\Delta N}{N} \right] + 0.3 \left[ \frac{\Delta K}{K} \right]$$

#### Recent Revisions to Potential Output by National Authorities

	Institution	Growth Revisions (percentage points)					Components affected		
		2007	2008	2009	2010	2011	Capital	Labour	TFP
United States	Congressional Budget Office (2009)			-0.1	-0.4	-0.2	x		x
Euro Area	European Commission (2009)	-0.4	-0.4	-0.8	-0.8		x	x	x
Germany	Deutsche Bundesbank (2009)			-0.5	-0.1	0.0	x	x	x
Japan	Bank of Japan (2009)			-0.5	-0.5	-0.5	x		
United Kingdom	HM Treasury (2009)	Phased in 5% reduction level of potential output over 2007Q3-2010Q3					x	x	x
Italy	Italian Treasury	-0.4	-0.3	-1.0	-0.8	-0.9	x	x	x
Canada	Bank of Canada (2009)			-1.2	-1.0	-0.6	x	x	x

Figure 4.1. Growth in capital services, 2000-10  
 Quarter-on-quarter growth, annualised rate



1. Weighted average of Germany, France, Italy and the United Kingdom.

Source: OECD Economic Outlook 85 database.

Figure 4.2. European unemployment ratchets up following severe recessions

(a) Major European countries

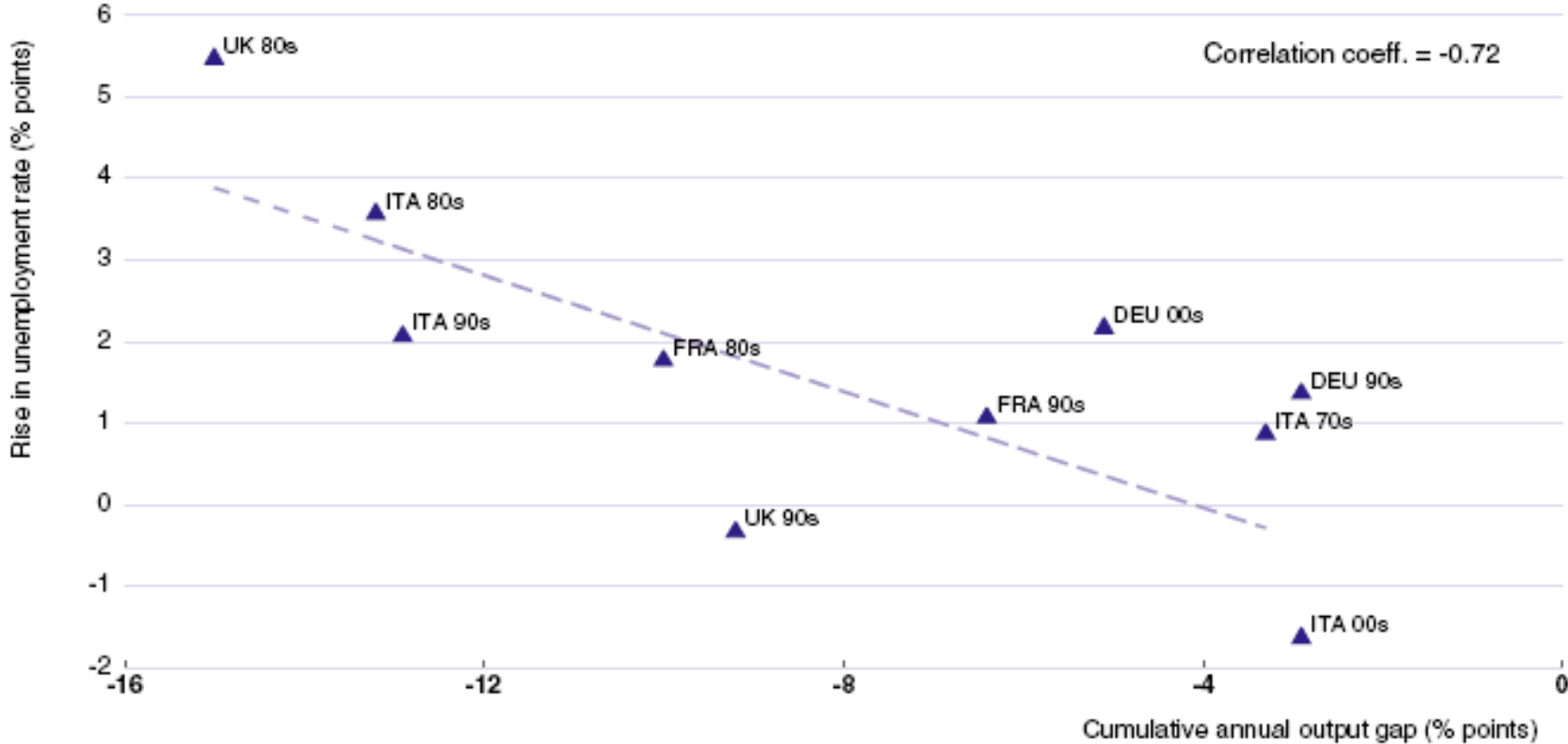
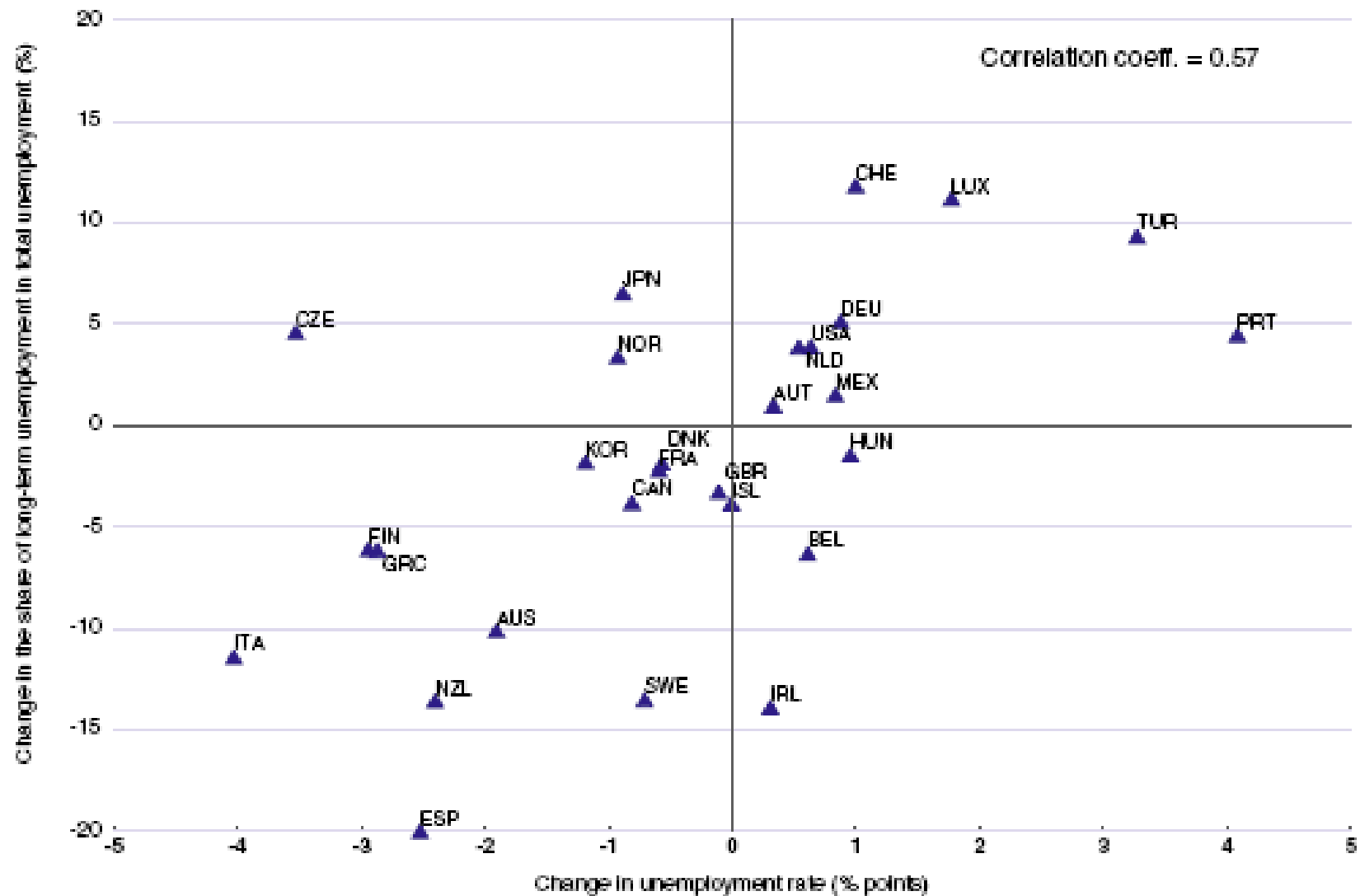
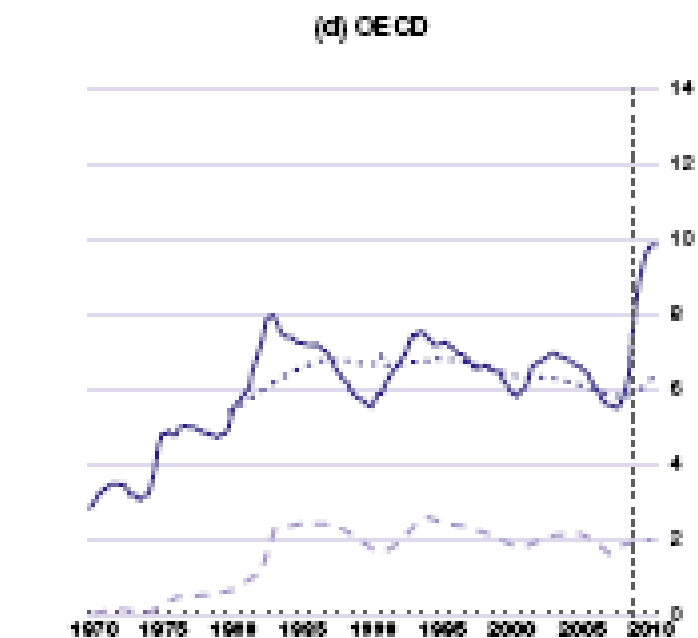
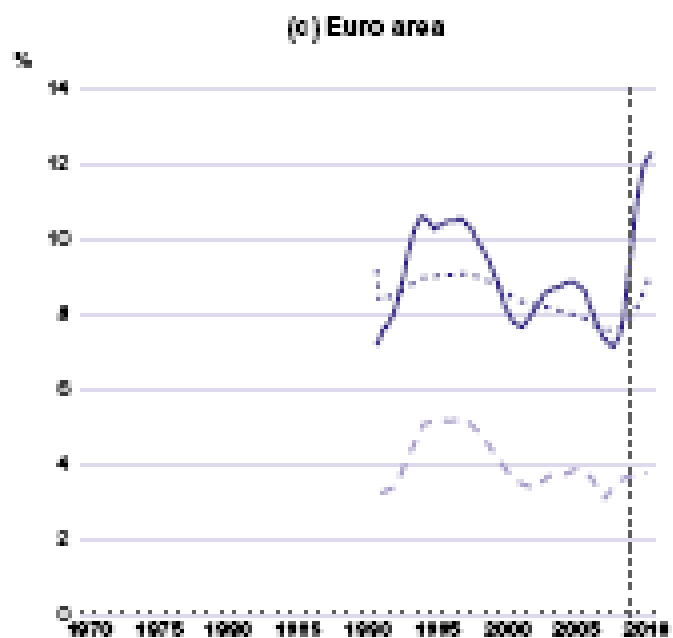
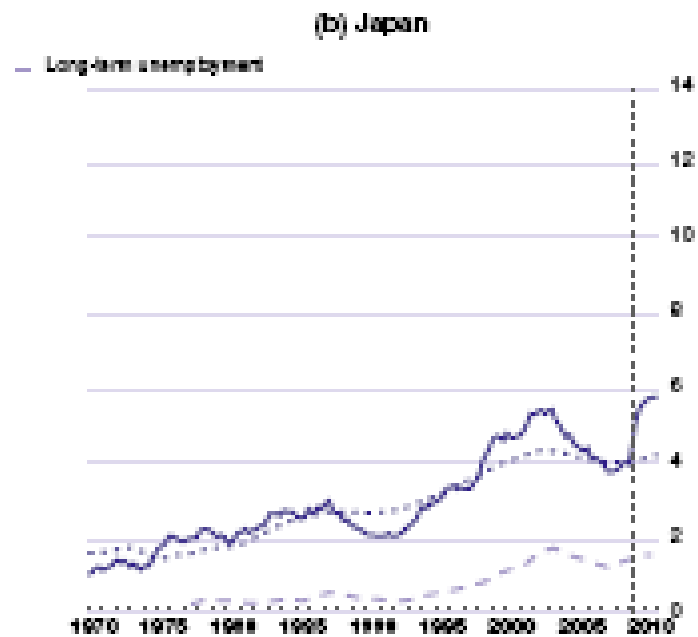
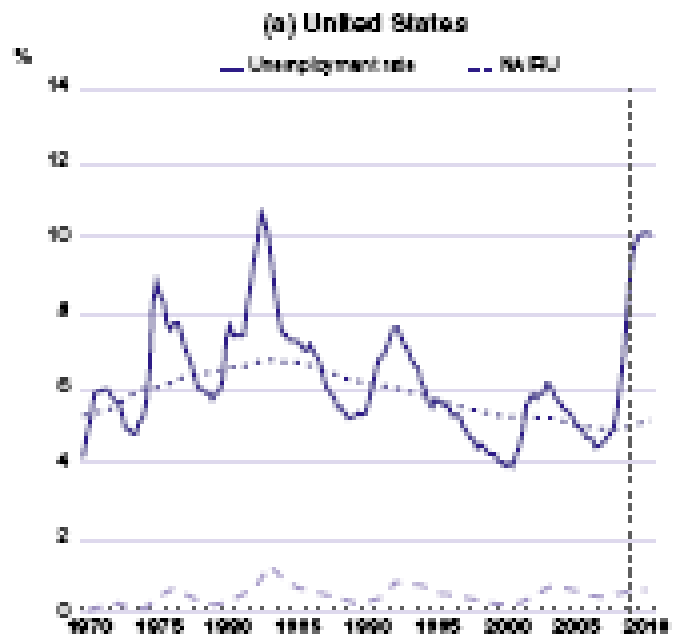


Figure 4.3. Changes in the incidence of long-term unemployment and aggregate unemployment, 2000-07



Source: OECD Economic Outlook 85 database; OECD calculations.



**Table 4.2. Growth in total economy potential output and its components**  
Annual averages, percentage points

	Output gap	Components of potential employment <sup>1</sup>																	
		Potential GDP growth			Potential labour productivity growth (output per employee)			Potential employment growth			Trend participation rate			Working age population			Structural unemployment <sup>2</sup>		
		2006-2008	2009-2010	2011-2017	2006-2008	2009-2010	2011-2017	2006-2008	2009-2010	2011-2017	2006-2008	2009-2010	2011-2017	2006-2008	2009-2010	2011-2017	2006-2008	2009-2010	2011-2017
	2010																		
Australia	-5.8	3.6	2.8	2.4	1.3	1.0	1.3	2.3	1.8	1.0	0.4	0.2	0.1	1.8	1.8	1.0	0.1	-0.2	0.0
United Kingdom	-6.4	2.2	1.3	1.7	1.4	1.3	1.6	0.8	0.0	0.1	0.0	0.0	0.0	0.8	0.3	0.2	0.0	-0.3	-0.1
United States	-5.4	2.4	1.5	2.0	1.7	1.0	1.5	0.7	0.5	0.5	-0.4	-0.6	-0.5	1.1	1.2	1.1	0.0	-0.1	0.0
Euro area	-6.0	1.7	0.9	1.3	0.7	0.9	1.2	1.1	0.0	0.1	0.5	0.3	0.2	0.4	0.2	0.0	0.1	-0.6	-0.1
Total of above OECD countries	-5.7	2.1	1.4	1.7	1.3	1.0	1.5	0.8	0.3	0.2	0.0	-0.1	-0.1	0.7	0.6	0.4	0.1	-0.2	0.0

1. Percentage point contributions to potential employment growth.

2. Estimates of the structural rate of unemployment are from Glanella *et al.* (2008), based on the concepts and methods described in OECD (2000).

3. Excluding the oil sector.

Source: OECD Economic Outlook 85 database.

Table 4.3. **Stylised medium-term scenario**

Per cent

	Real GDP growth	Inflation rate <sup>1</sup>		Unemployment rate <sup>2</sup>		Long-term interest rate	
	2011-2017	2010	2017	2010	2017	2010	2017
Australia	3.2	2.2	2.5	7.7	5.7	4.3	6.3
Switzerland	2.1	0.6	1.1	5.1	4.1	2.9	3.1
United Kingdom	2.7	1.0	2.1	9.7	6.3	4.4	5.5
United States	2.8	0.8	2.0	10.1	5.2	4.1	5.2
Euro area	2.3	0.7	2.0	12.0	9.4	4.4	4.9
Total OECD	2.7	0.8	2.0	9.8	6.5	4.1	5.0

Note: For further details see *OECD Economic Outlook Sources and Methods* (<http://www.oecd.org/eco/sources-and-methods>).

1. Percentage change from the previous period in the private consumption deflator.

2. Per cent of labour force.

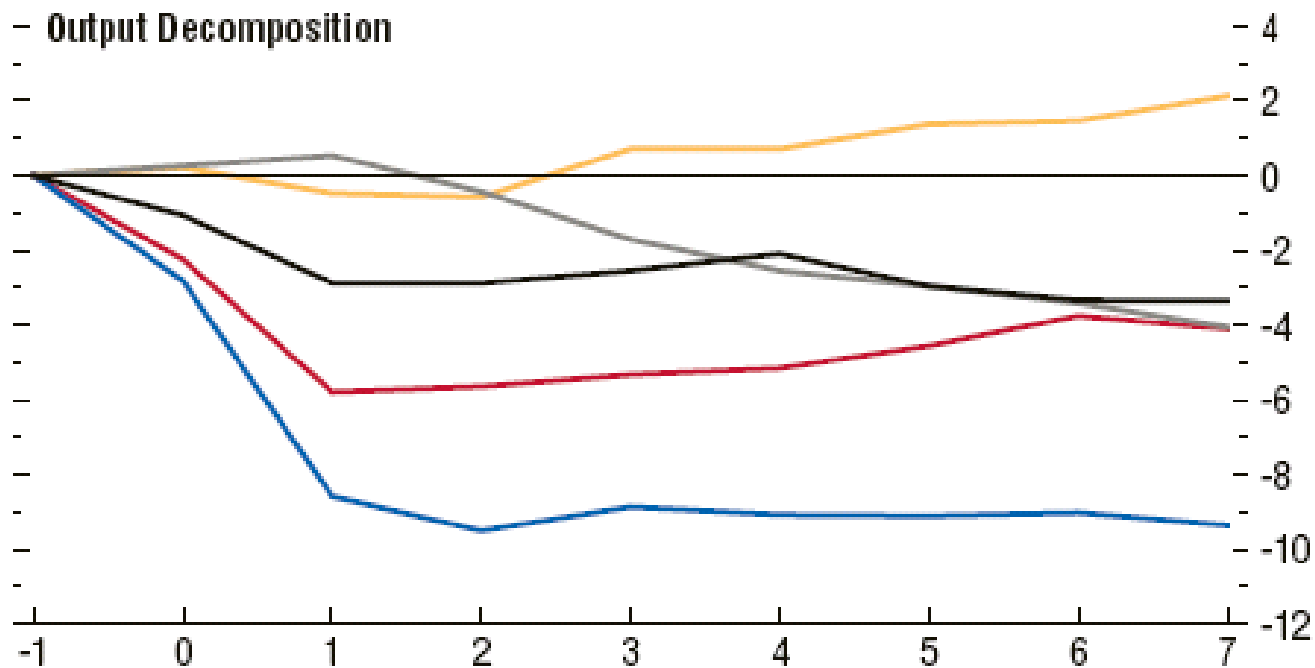
3. Including oil-sector.

Source: OECD Economic Outlook 85 database.

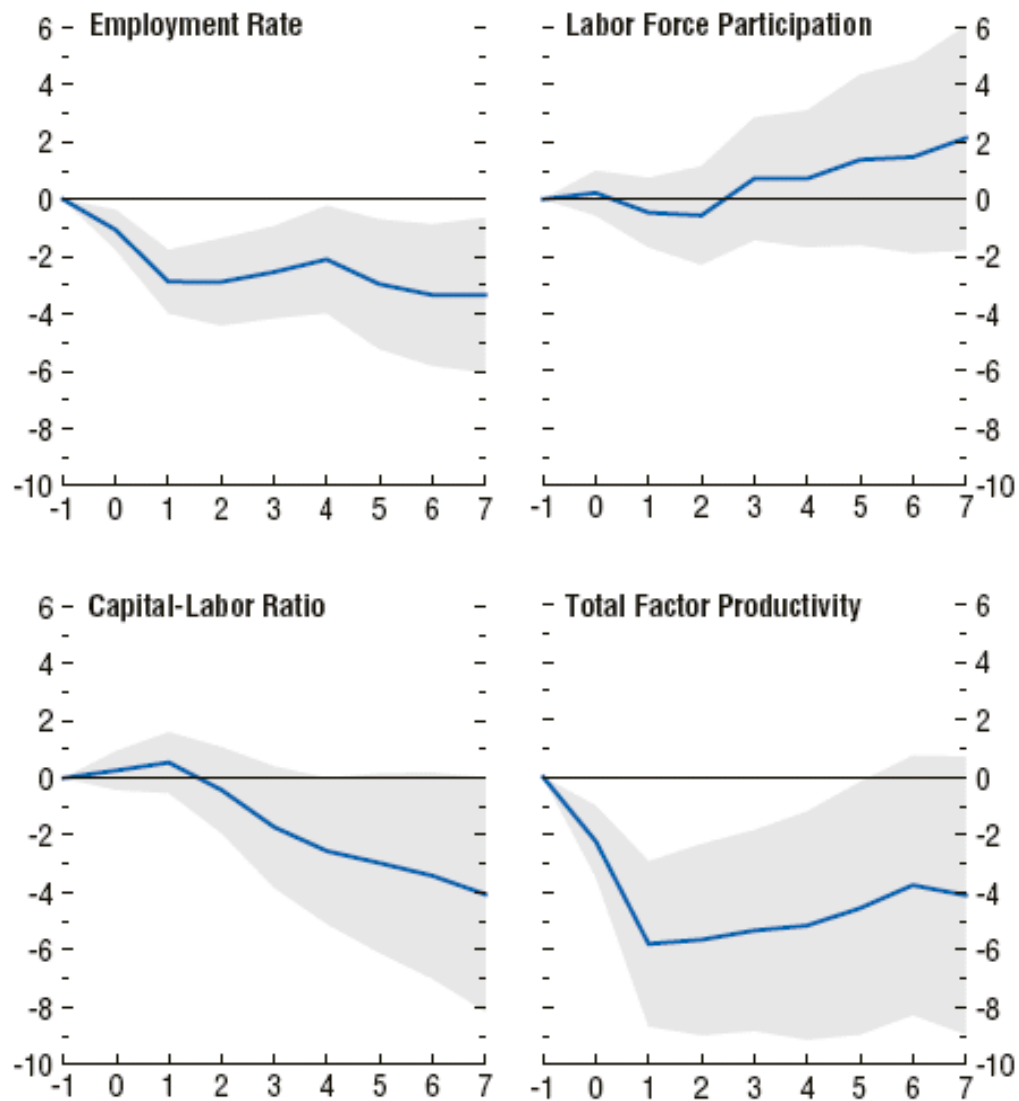
## Figure 4.6. Output Decomposition

(Percent of precrisis trend; mean difference from year  $t = -1$ ; first year of crisis at  $t = 0$ ; years on  $x$ -axis)

- Output
- Labor force participation
- Capital-labor ratio
- Total factor productivity
- Employment rate



— Mean    90 percent confidence interval



Sources: Bosworth and Collins (2003); World Bank, *World Development Indicators*; and IMF staff calculations.

# What Policies Are Associated w/Small Declines?

- Aggressive macroeconomic support at the time of the crisis start
- Structural adjustment:
  - domestic financial reform,
  - capital account and trade liberalization
  - structural fiscal reform
- Lower global short term interest rates