CAN YOU SPEND YOUR WAY OUT OF A FINANCIAL CRISIS?
THE CASE OF THE EU SPENDING POLICIES

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13 OCTOBER 2015
MOTIVATION

- Financial crisis in 2008-10: Return on investment reduced by 15-20%.

- To mitigate the impact and increase GDP, some EU governments wanted to encourage HH to increase spending (i.e. reduce saving) towards locally produced goods.
  - Actual saving rates in the EU was about 11% in 2009 (before financial crisis).

- However, the effects of such policies are not known.
OBJECTIVE

TO ASSESS THE IMPACTS OF THE SPENDING (SAVING) POLICIES ON:

- GDP
- CONSUMPTION
- INVESTMENT
- WELFARE (2020 AND 2050 HORIZONS)
- INCOME FROM CAPITAL OWNERSHIP
### Closures and Shocks

<table>
<thead>
<tr>
<th></th>
<th>1. Baseline</th>
<th>2. Financial Crisis</th>
<th>3. Financial Crisis + Spending policies</th>
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</thead>
<tbody>
<tr>
<td><strong>Financial shocks</strong></td>
<td>None</td>
<td>srorge= -25% (2005-10) srorge= -10% (2010-15)</td>
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<tr>
<td><strong>Decrease in Saving rates</strong></td>
<td>None</td>
<td>None</td>
<td>Dpsave = -15% (2010-15)</td>
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<td><strong>Encourage HH investment on local firms</strong></td>
<td>None</td>
<td>None</td>
<td>Swqhf = +10% (2010-15)</td>
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IMPACTS ON GDP

**GDP (million dollars)**

- Base
- Financial crisis
- Financial crisis + spending policy

**GDP (% change versus baseline)**

- Financial crisis
- Financial crisis + spending policy
IMPACTS ON INVESTMENT (QCGDS)

Investment (% change versus baseline)

-25 -20 -15 -10 -5 0 5

2010 2015 2020 2025 2030 2035 2040 2045 2050

financial crisis  financial crisis + spending policies
WELFARE DECOMPOSITION (SHORT AND LONG RUN)

Welfare Change (2020)

Welfare Change 2050

financial crisis  financial crisis + spending policies
IMPACTS ON INCOME FROM OWNERSHIP OF CAPITAL ENDOWMENT

Income capital ownership 2020

Income capital ownership 2050
WHAT HAPPENED TO ACTUAL RATE OF RETURN?

Financial crisis

Financial crisis + spending policy
CONCLUSION

• FINANCIAL CRISIS REDUCES GDP BY 8% IN 2020
  • BUT IN THE LONG RUN (2050) THIS NEGATIVE EFFECT VANISHES

• POLICIES ENCOURAGING HH TO INCREASE SPENDING (I.E. REDUCE SAVING) AND TOWARDS DOMESTIC GOODS REDUCE GDP BY 10% (VS. BASE) AND BY 2% (VS. FINANCIAL CRISIS SCENARIO)
  • IN THE LONG-RUN (2050) THIS POLICY EFFECT PERSISTS (GDP FALLS BY 4% VS BASE)

• GOVERNMENT POLICIES TO INCREASE GDP BY ENCOURAGING HH TO INCREASE SPENDING (REDUCE SAVING) AND BUY MORE DOMESTIC GOODS TO INCREASE GDP PRODUCE THE OPPOSITE EFFECTS

• => YOU CANNOT SPEND YOUR WAY OUT OF A FINANCIAL CRISIS!