

The unifying theme of this dissertation is economic growth in a broad sense. On one hand, economic growth is influenced by productivity growth that has economic consequences for converging economies, which gradually catchup to those that are more advanced. On the other hand, economic growth is influenced by fiscal policy, more specifically by government decisions about taxes and government expenditure. This dissertation consists of three separate chapters.

In the first chapter, I focus on the Balassa-Samuelson (henceforth B-S) effect in the context of the convergence of the Czech Republic to the Euro Area. The B-S effect implies that highly productive countries have higher inflation and appreciating real exchange rates because of larger productivity growth differentials between tradable and nontradable sectors relative to advanced economies. The B-S effect may pose a threat to converging European countries that would like to adopt the Euro because of the limits imposed on inflation and nominal exchange rate movements by the Maastricht criteria. Thus, the main goal of this study is to determine whether the B-S effect is a relevant issue for the Czech Republic in complying with selected Maastricht criteria before adopting the Euro. For this purpose, I build and estimate a two-sector DSGE model of a small open economy. The simulations from the model suggest that the B-S effect is not an issue for the Czech Republic when meeting the inflation and nominal exchange rate criteria. The costs of early adoption of the Euro are not large in terms of additional inflation pressures, which materialize mainly after the adoption of the single currency. In addition, nominal exchange rate appreciation, driven by the B-S effect, does not breach the limit imposed by the ERM II mechanism.

In the second chapter, I build a structural fiscal DSGE model to address four important issues of Czech fiscal policy. I calculate fiscal multipliers for several revenue and expenditure categories of the government budget, the largest of which after the first year are government consumption (0.6), government investment (0.5), and social security contributions paid by employers (0.4). I use fiscal multipliers to derive the appropriate composition of growth-friendly fiscal strategies, e.g., I determine that the composition of temporary fiscal consolidation is more revenue-based, raising mainly consumption tax (a share of 30% in the composition) and wage tax (17%), accompanied by cuts in other social benefits (35%) on the expenditure side. In addition to the output effects, I also evaluate welfare effects of different fiscal stimuli. Furthermore, I show that fiscal devaluation can boost real GDP growth by 0.5 percentage points in the first year, when a budget-neutral tax shift of the magnitude of 1% of GDP occurs from direct to indirect taxes. These results corroborate the view that the government can easily support the economy by appropriately adjusting fiscal instruments.

In the third chapter, I address past fiscal discretion in the Czech Republic. I find that fiscal discretion in the Czech Republic was used frequently, and that some sizeable impacts on real GDP growth have been recorded, particularly in years 2004, 2009, and 2016, with estimated impacts reaching about 1.0–1.5 p.p. in real GDP growth. Further, I find that fiscal discretion in the Czech Republic was pro-cyclical in years 2008, 2010, 2012–2013, and 2016–2017, whereas it was counter-cyclical in 2009, 2011, and 2014–2015. A clear link between fiscal discretion and the business cycle cannot be distinguished, suggesting that, on average, Czech fiscal discretion has not contributed to stabilizing business cycle fluctuations. Finally, if past fiscal discretion in the Czech Republic had had a better growth-friendly composition, as was proposed by fiscal strategies in the second chapter of this dissertation, then real GDP could have grown faster by approximately 1.8 pp in cumulative terms over the 2001–2017 period.