Fiscal devaluation is a tax policy dedicated to restoring price competitiveness among countries unable to devaluate their domestic currencies. Fiscal devaluation assumes the reduction of taxes on inputs, especially on labour, usually employers' social security contributions, what directly strengthens price competitiveness of domestic production. Simultaneous increase in indirect taxes, notably value-added taxes and property taxation, necessary for avoiding increasing deficit and sovereign debt, spur domestic retail prices to increase. Although it hampers real purchasing power of nominal wages, it does not harm an impact of fiscal devaluation for advancing price competitiveness of domestic firms. In turn, one can expect an increase in exports and decrease in imports.

Although the idea of fiscal devaluation has found considerable support in the literature and among international organisations, IMF and European Commission included, as a tax policy able to restore competitiveness and thus economic growth in indebted southern Euro area countries, neither numerous general equilibrium model-based simulations nor few empirical cross-country studies offer clear cut evidence on the possible outcomes of this policy measures or factors affecting its magnitude or persistence. The primary goal of this research project is to critically evaluate an impact of fiscal devaluation on economic performance in the EU countries in the period 1995-2015 with a particular stress put on economic and institutional factors determining its magnitude, persistence and cross-country spill-overs. Contrary to the limited existing empirical research using aggregated macroeconomic data, the planned study will investigate the effects caused by fiscal devaluation using mainly sectoral and firm-level data. In order to explore non-linear effects of fiscal devaluation, these two core datasets will be merged with other datasets capturing features that are likely to significantly influence channels through which fiscal devaluation affects economic performance.

To our best knowledge, there is no empirical research exploring how sectors' and firms' heterogeneity influences a significance of the effects of FD. Empirical studies devoted to the analysis of the abovementioned issues are necessary for an in-depth understanding of the outcome of FD policy.

The proposed study will examine a magnitude of the effects of FD by applying panel and spatial panel models with interaction variables that enable exploring non-linear relationships between analysed variables. In order to examine the persistence of the effects of FD, i.e. changes of its magnitude over time, the research will also use panel local projection models. To our knowledge, they have never been used in assessment of the persistence of the effects of FD.

The study will significantly contribute to the development of the state of knowledge on how and under what circumstances FD enhances economic activity as well as what factors determine the persistence of these effects. The project – due to the use of sector and firm level data supplemented with datasets on sector and country specific factors – will make a major contribution to the analysis of the effects of FD for country, sectors' and firms' economic outcomes.