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EUROSYSTEMET

Fiscal Policy in Europe, comments on Müller

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Views expressed are my own and do not necessarily
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General setting

- ◆ The financial crisis has reignited interest in efficacy of fiscal policy.
- ◆ Popular discussions in broad terms such as
 - expansionary vs. restrictive fiscal stance,
 - austerity.
- ◆ Analytical approach:
 - discussion is often in terms of the **multiplier**,
 - tools from macroeconomics give quantitative estimates of the multiplier.
- ◆ Gernot's presentation is very much in this tradition.



The multiplier concept

- ◆ There are different concepts:
 - Expenditure multiplier, tax multiplier etc.
- ◆ Purely empirical estimates
 - Time series, "natural experiments"
- ◆ Model-based estimates use number of assumptions:
 - Flexible vs. sticky prices and/or wages
 - Monetary policy (and exchange rate regime)
 - Openness of the economy
 - Health of the financial system
 - Fiscal situation: credible policy vs. fiscal stress
 - Duration of stimulus
 - Expectations formation



Two methodologies

- ◆ Corsetti, Meier, Müller, EP 2012:
 - empirical rule for fiscal policy to identify government spending shocks
 - employs estimated shocks in a time-series model for macro variables, look at impulse responses
 - allows for alternative economic environments: exchange rate peg, weak public finances, financial crisis
- ◆ Corsetti, Kuester, Meier, Müller, EJ 2013:
 - closed-economy New Keynesian model with useful focus on adverse borrowing conditions for the private sector.
 - model-based analysis of focusing on the **zero-lower bound** for monetary policy and **sovereign risk**.



Comments on results

- ◆ Literature has a number of conflicting results.
- ◆ CMM, EP 2012:
 - under financial crisis expansionary fiscal spending has relatively big impact on output and even positive impact consumption and investment
 - weak public finances have surprisingly small differential impact, except for private consumption.
- ◆ CKMM, EJ 2013:
 - possibility of expansionary austerity is surprising, but
 - there is sensitivity of results to size of the sovereign risk channel



Comments continued

- ◆ The open-economy case is intriguing.
 - With sovereign risk channel, there seems to be a “win-win” situation for effects of austerity.
 - expansionary (or only slightly negative) effect on output and
 - good outcome (bigger reduction) for public debt
 - Without sovereign risk channel, austerity has significant negative impact on output and less reduction in public debt.
 - Less favorable effects than with sovereign risk channel
 - What does this suggest about OMT and austerity?
- ◆ Technical comment:
 - Monetary policy is locally passive at ZLB, also passive fiscal policy is assumed. => indeterminacy in the simple NK model.
 - Do you get determinacy, why?



Comments continued

- ◆ Conclusion "fiscal stance in Europe is about right" leads to following observations:
 - Implications of the sovereign risk channel suggest that indeed austerity has a rationale.
 - For the AAA euro area countries, CMM results suggest that the nearly ZLB monetary policy regime has fairly large multipliers.
 - This accords with other papers like Christiano et al JPE 2011.
- => Question: is the fiscal stance about right also for the AAA countries?