Keynesian Government Spending Multipliers and Spillovers in the Euro Area (T. Cwik and V. Wieland)

Discussion by
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Usual disclaims hold

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Goal, results, policy implications

- Goal: to assess public spending multipliers and fiscal stimulus package in the euro area
- Tools: traditional Keynesian and new-Keynesian DSGE models
- Result 1: no multiplier under forward-looking behaviour
- Result 2: negligible or even negative spillovers from the German stimulus package
- Result 3: with implementation lags, negative initial effect of anticipated fiscal stimulus
- Result 4: euro area interest rate constant for one year implies only slightly larger multiplier than under normal monetary policy

Determinants of government spending multipliers in a standard new-Keynesian DSGE model

- Fiscal rule (tax- and/or public expenditure- based)
- monetary policy (forward-looking households) :
  - if mon. pol. **not** accomodative, higher aggregrate demand implies higher real interest rate, that offsets fiscal stimulus;
  - if mon.pol. accomodative, higher demand implies high inflation and, hence, lower real interest rate (stimulus is magnified)
- Share of non-Ricardian households (relatively low in normal periods)
- Cross-country spillovers: trade

L. Forni M.Pisani (2009, preliminary) gov. spending multipliers in the euro area

	GDP	CPI Ann.	Primary Pub. Def.
Impact	0.92	0.25	0.54
One year	0.62	0.23	0.51
Two Year	0.18	0.10	0.40

Suggestion 1: role of fiscal rules

- Clarify in the paper the role, if any, of fiscal rule(s)
- Laxton and Pesenti (2003, JME): neither distortionary taxation nor public debt
    - Why not simulating IMF GIMF (Kumhof and Laxton) as well?
- In theory, fiscal rules can be relevant for the size of government spending multipliers
- Our (preliminary) empirical evidence for the euro area suggests that fiscal rules are tax-based with relatively small reaction to changes in public debt

Suggestion 2: role of monetary policy

- if mon. pol. **not** accomodative, higher aggregrate demand implies higher real interest rate, that offsets fiscal stimulus;

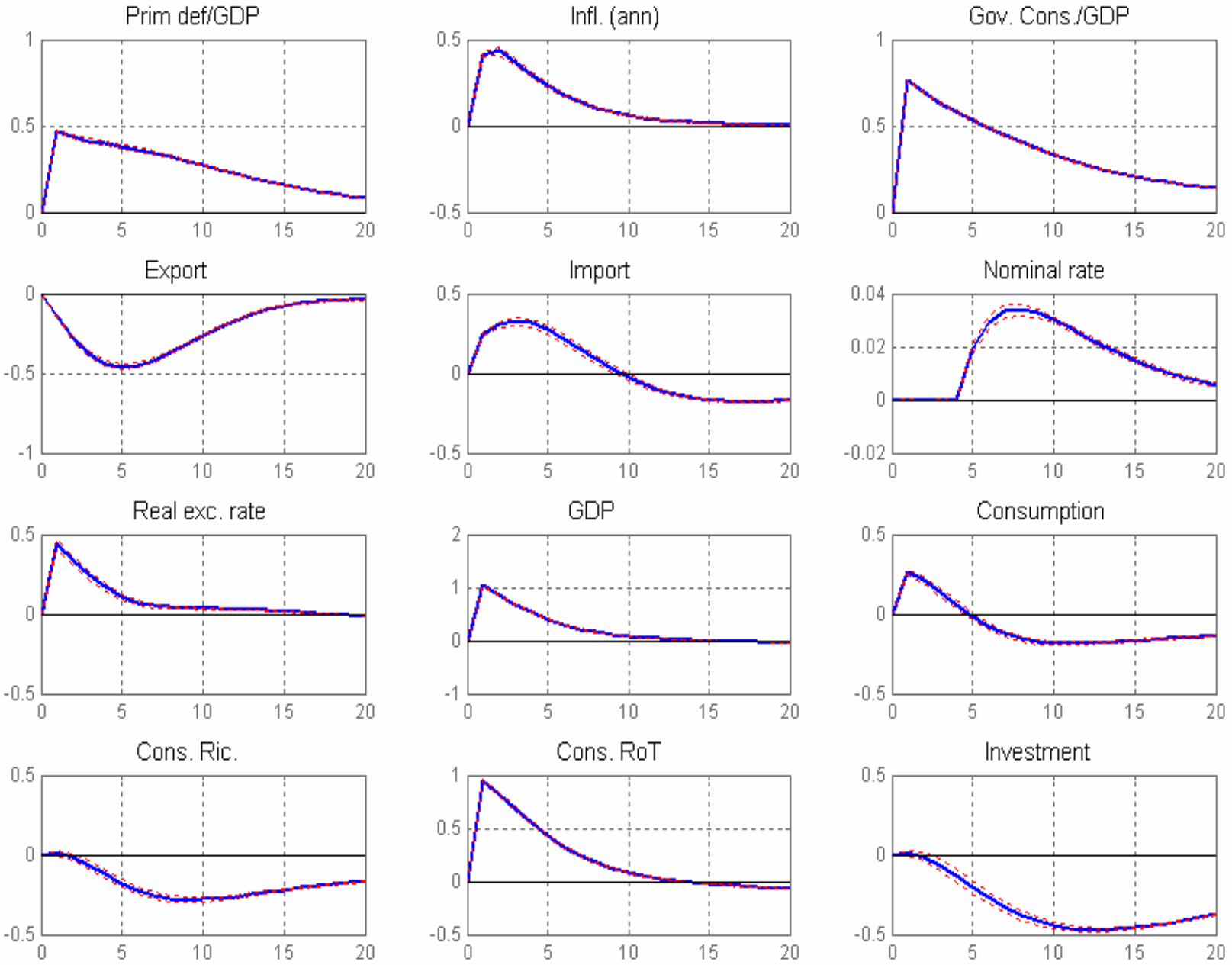
- if mon.pol. accomodative, higher demand implies high inflation and, hence, lower real interest rate (stimulus is magnified)

- Try to clarify in the paper why multiplier does not greatly change btw the two cases

- Guesses: Strenght of reaction to (yearly) inflation? Nominal rigidities are relatively high in the euro area (5-6 quarters)?

L. Forni M.Pisani (2009, preliminary) gov. spending multipliers in the euro area

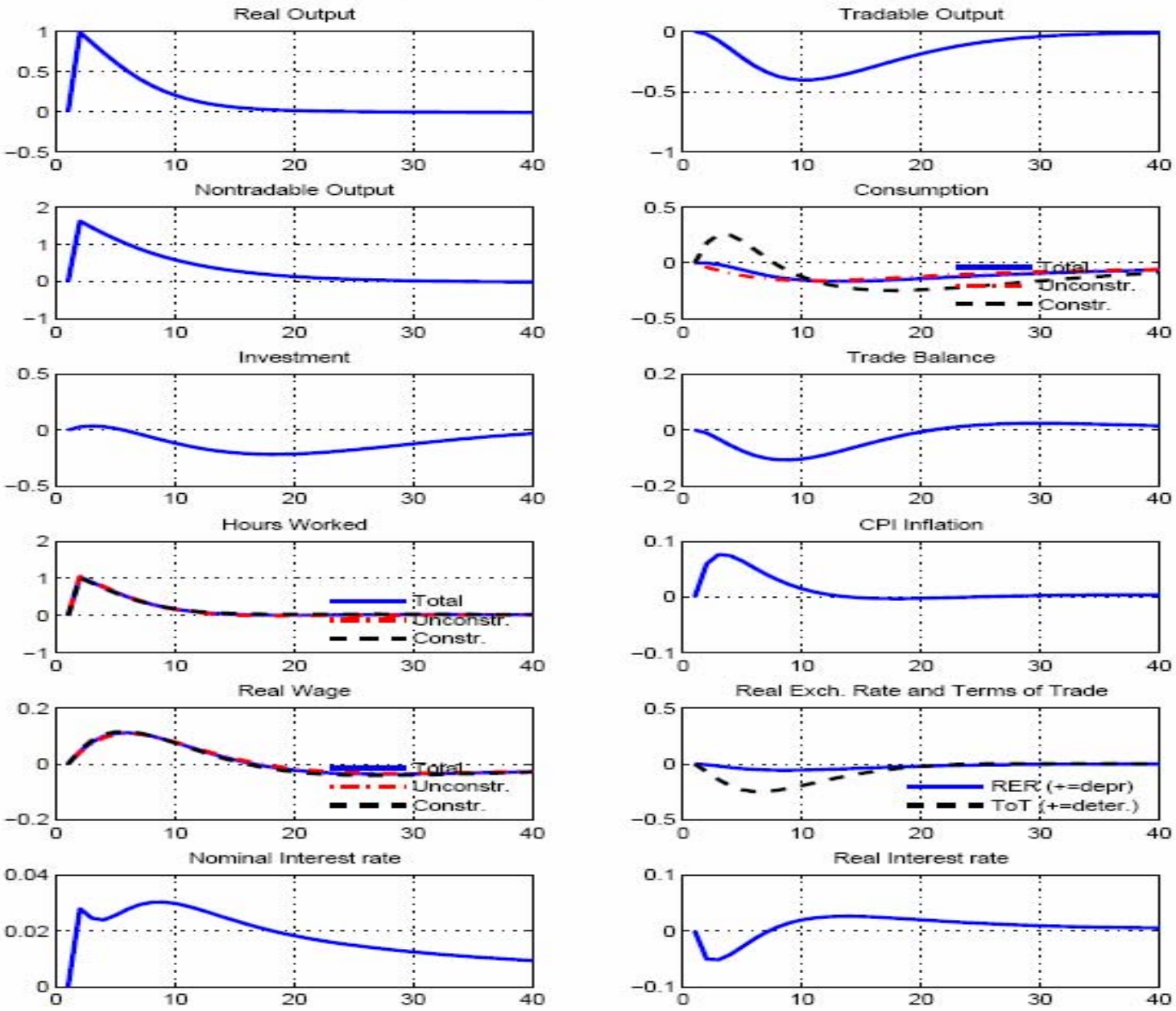
	GDP	CPI Ann.
Impact (benchmark) ***Constant policy rate***	0.92 ***1.04***	0.25 ***0.42***
One year	0.62 ***0.78***	0.23 ***0.39***
Two Years	0.18 ***0.27***	0.10 ***0.17***


Prim def/GDP
Infl. (ann)
Gov. Cons./GDP
Export
Import
Nominal rate
Real exc. rate
GDP
Consumption
Cons. Ric.
Cons. RoT
Investment

Suggestion 3: trade spillovers

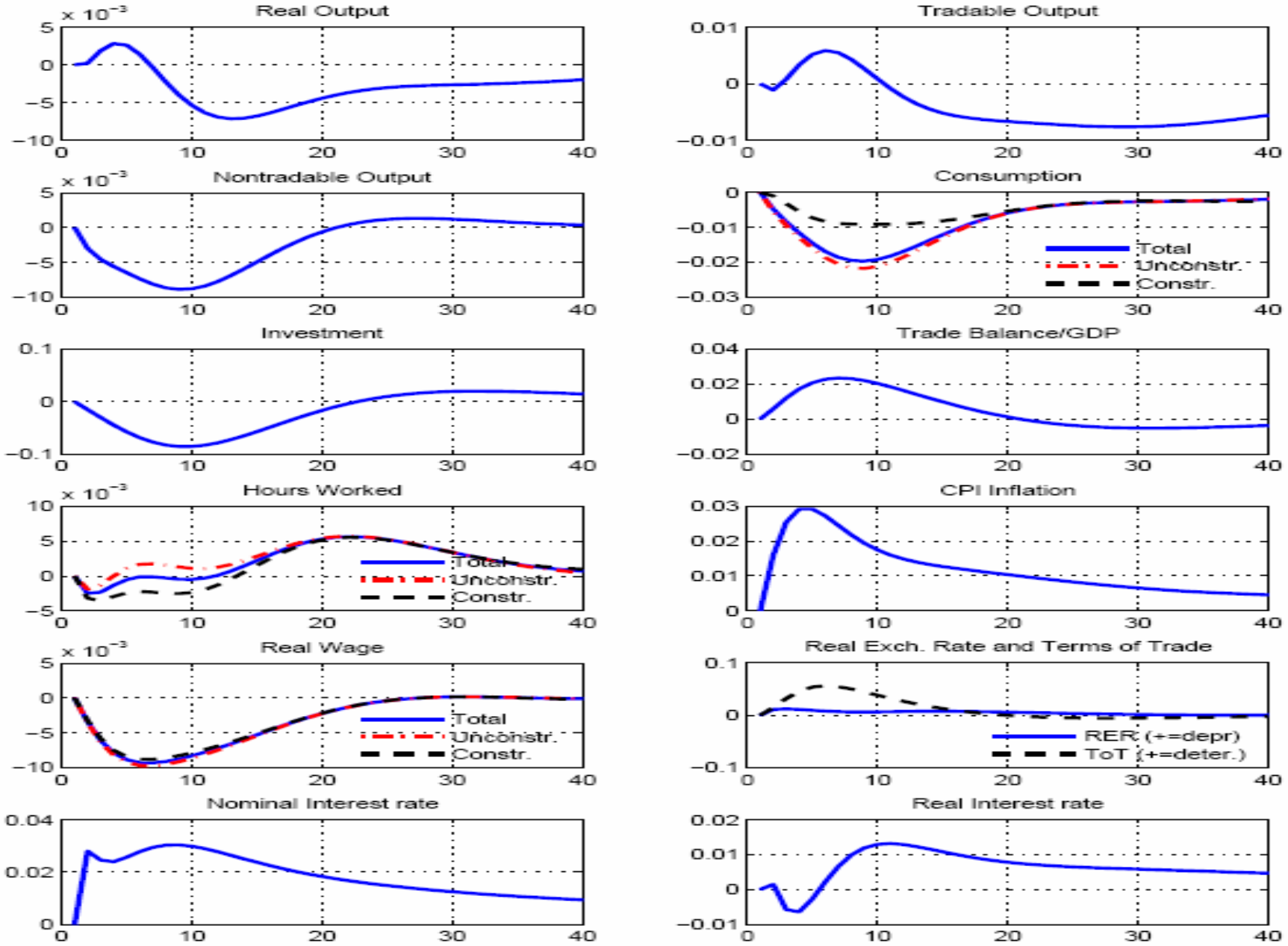
- Euro exchange rate appreciation is crucial for the result
- What would happen with accomodative monetary policy? Euro would depreciate contributing to stimulate euro area net export.
- Moreover: the (exchange rate) indirect effect seems too strong; in DSGE models standard import adjustment costs, sluggish reaction of monetary policy, local currency pricing would attenuate that effect, at least in the short run
- (Preliminary) evidence from a multi-country DSGE model of the euro area (S. Gomes, P. Jacquinot, M. Pisani 2009): under standard monetary policy, trade-related spillovers are small in correspondence of a public expenditure shock fully biased towards nontradables

Figure 2a. Positive Home public expenditure shock. Domestic effects.



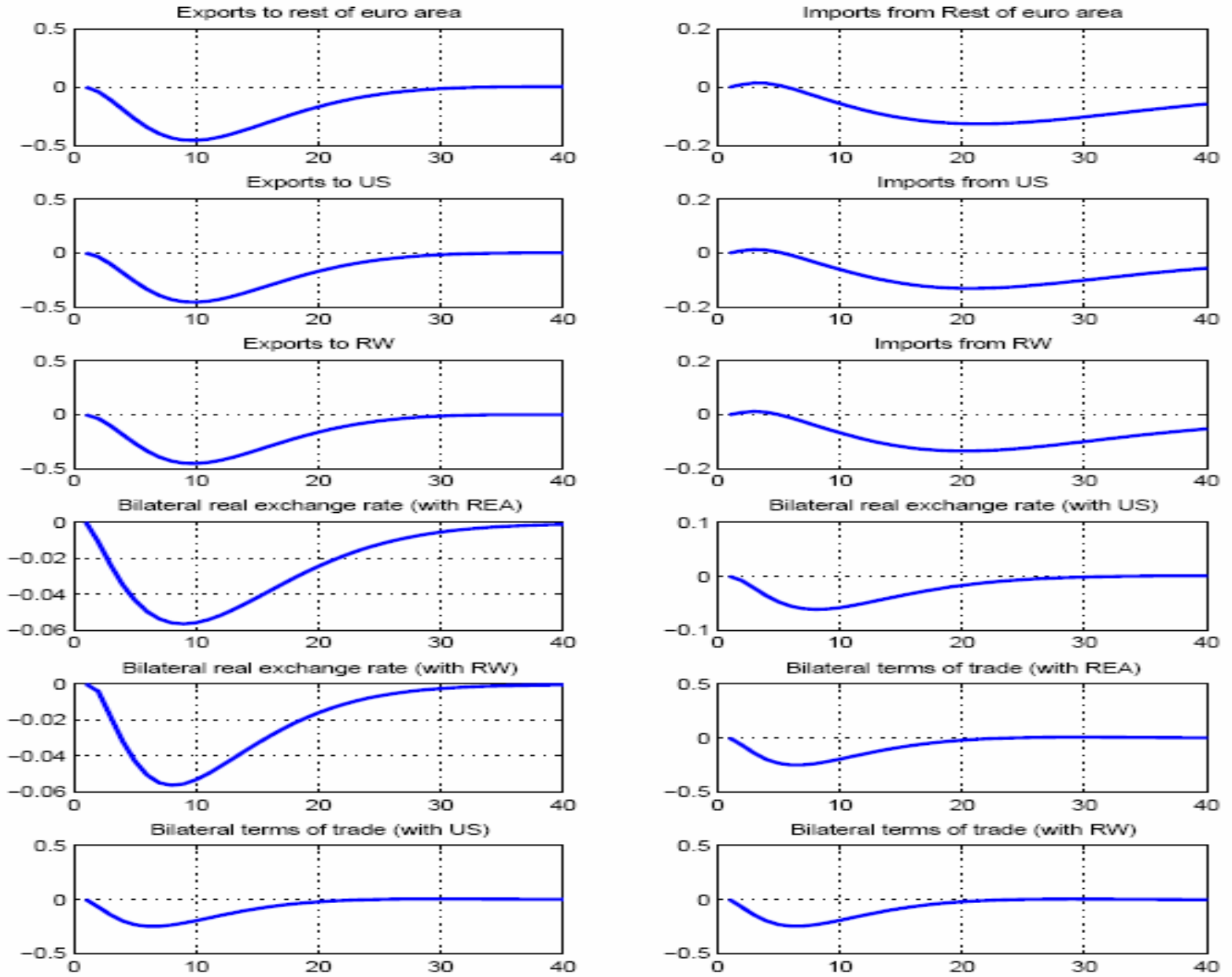
Horizontal axis: quarters. Vertical axis: percentage deviations from the baseline, except for inflation and interest rates, reported as percentage-point deviations.

Figure 2b. Positive Home public expenditure shock. Effects on rest of euro area.



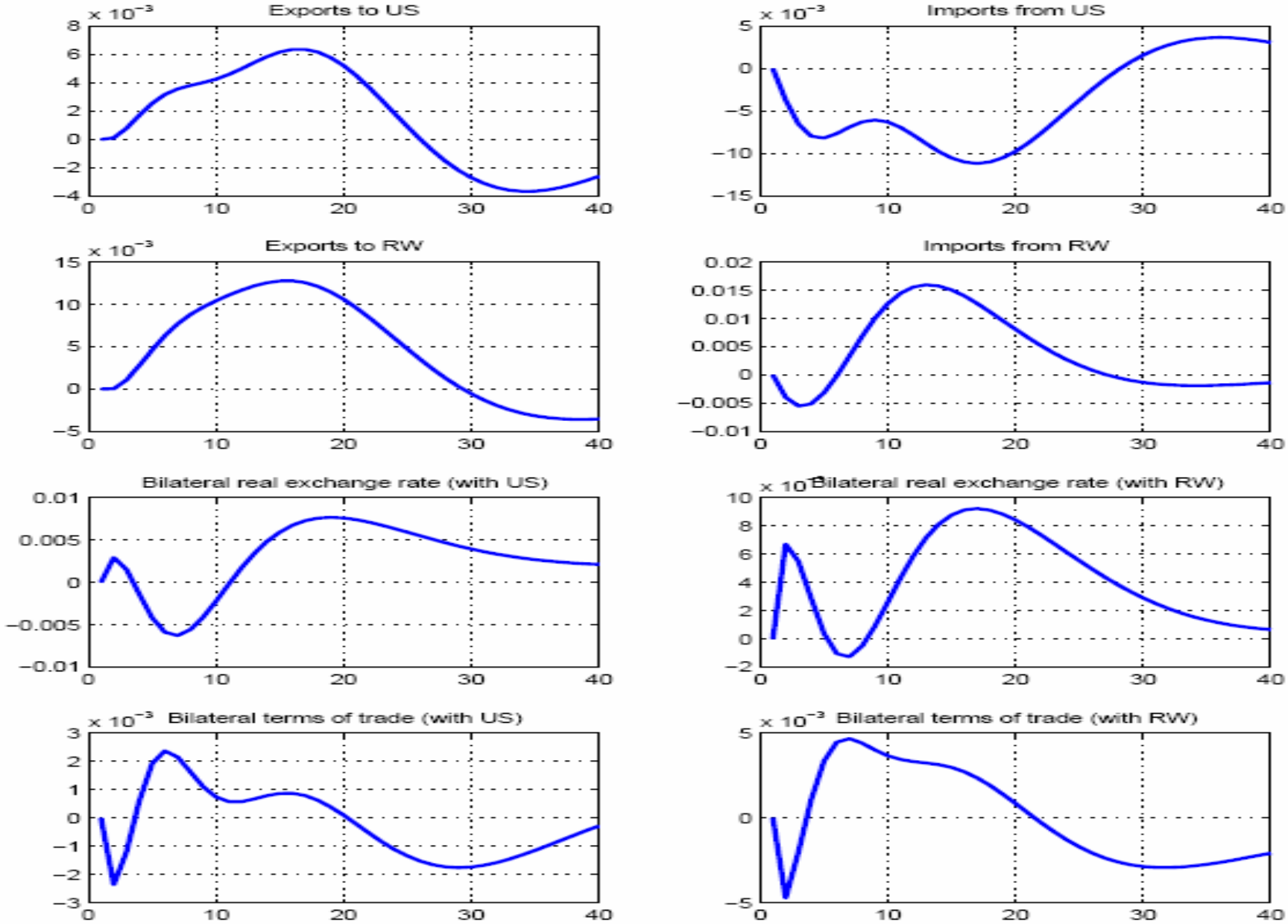
Horizontal axis: quarters. Vertical axis: percentage deviations from the baseline, except for inflation and interest rates, reported as percentage-point deviations.

Figure 2c. Positive Home public expenditure shock. Effects on Home trade variable.



Horizontal axis: quarters. Vertical axis: percentage deviations from the baseline, except for inflation and interest rates, reported as percentage-point deviations.

Figure 2d. Positive Home public expenditure shock. Effects on rest of euro area trade variables.



Horizontal axis: quarters. Vertical axis: percentage deviations from the baseline, except for inflation and interest rates, reported as percentage-point deviations.

Question: public spending multipliers and modelling the financial crisis

- Lower access to financial market (binding borrowing constraint, higher share of ROT)
- Unconventional monetary policy
- Large deflationary shocks and ZLB in closed and open economy

To sum up

- Renewed interest in fiscal policy has increased the use of quantitative structural models to evaluate policy
- Because of modelling uncertainty, it is essential that policy evaluations be robust to alternative assumptions
- Tobias and Volker address the issue by using a portfolio of models
- The paper would benefit from robustness analysis in the DSGE model, in particular the spillover effects section
- General question (food for thought): not clear that the available models are well-suited for analyzing fiscal issues in a financial crisis