Comments on Benigno and De Paoli

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A timely paper on an important issue,

- in the times of huge public deficits.
- One (or two, or three) notch up the technological ladder of optimal policy in DSGE.
- Hence an important contribution on the subject.

The message

- Terms of trade externalities can be exploited by policymakers, including fiscal policies.
- An important consequence: an incentive to vary taxes over time, according to the state of nature / current supply shocks.
- The optimal policy depends on the type of financial instrument used by the Treasury, and on the extent of price sluggishness.
- Actually, openness mitigates the use of inflation.

To summarize

- A DSGE model of a SOE vs RoW.
- International basket of goods with home bias.
- Law of one price.
- Calvo pricing.
- A cashless economy.

To summarize

- The fiscal instrument : a distortionary income tax.
- Exogenous public expenditures.
- A time-varying mark-up shock.
- Public debt indexed / Not indexed.

The crucial feat of the paper (as in de Paoli, 2008).

The second-order approximation of the welfare function exhibiting a terms of trade term,

due to the relaxation of the unit elasticity assumption.

Issue: A cashless economy

B. and de P. follow a standard / common line of research.

Is it the best way when discussing the policy mix?

Seigniorage revenues: yes, small ... in normal times.

The role of liquidity aggregates in monetary policy.
Solely inflation does not suffice, seen from today's point of view.

Remember the existence of DSGE models with money for policy exercise. (Correia, Nicolini, Teles, 2008)

Issue: A cashless economy

If money is not disappearing, then it is less easy to study monetary policy ... and fiscal policy.

New sources of distorsions, new dilemma for policymakers.

Where do we stand with respect to the Friedman rule?

Issue: The price level indeterminacy problem

Here the problem is present.

Recent advances in the DSGE stream on this important topic.

Atkeson, Chari, Kehoe, 2009.

Issue: About instruments and plans

The fiscal instrument: a tax rate.

The monetary instrument: the inflation rate / the nominal interest rate (implicitly)

The obtention of optimal plans.

However no clear discussion of instrument values, except in special cases.

Are these plans always attained?

Issue: About policymakers

An ambiguity: two policymakers, divided or cooperating?

Implicitly, cooperating so as to satisfy the optimal policy plan.

Is cooperation important for the result? Cf. Dixit - Lambertini.

The result of Kempf-von Thadden about static LQ models.

Does it generalize in a dynamic framework?

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Technicalities

- The dynamics of the economy. Some (real) variables may not be stationary, after linearization.

  Is it a problem?

- The dynamic problem of the RoW: is it needed?