

Discussion of Bilbiie, Monacelli & Perotti: “Is government spending at the ZLB desirable?”

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- Linearized NK model:
 - no role for G
- Linearized NK model + ZLB:
 - role for G
- This paper: any role for G is artefact

- Case for G relies on starvation
 - $MU(C)$ very high
 - C -multiplier very high
 - Why? Asymptotics introduced by linearization/unrealistically large recessions
- Absent linearization, only way to get to starvation is Depression scenario
 - In which (only) useful G does have a role

Questions/comments: details

- How strongly are we willing to rely on welfare calculations?
 - Arguably we don't do a very good job at those generally
- Certain functional form assumptions/frictions can have a big quantitative impact
 - Variations on preferences (e.g. habits, GHH, ...)
 - Can change how much one rides the asymptote
- The paper argues (convincingly) that the size of the Great Recession does not warrant big interventions
 - But important features of the GR are left out
 - E.g. what happened to κ ?
- Assumes the ZLB is not absorbing state
 - verdict still out on that one?

Questions/comments: details

- Really are quibbles
- Summary:
 - great point
 - well made

Where to go from here?

- One way to view this paper's critique is:
- A non-validated (it's semi-linear ZLB G) implication of the NK model is taken to be true
- Paper: wrong
- Fair enough
- Authors go on to study full non-linear implications (in this and subsequent paper)

Where to go from here?

- Authors go on to study full non-linear implications
- OK, as microfoundations' implications should be fully understood
- BUT essentially ALL non-linear implications of the NK model are not validated
- After all, many of the “micro-foundations” were reverse-engineered
- Reverse-engineered: adopted not just for micro plausibility, equally (if not more) for their implied **linearized** aggregate empirical appeal
- Taking the non-linear implications to be true, requires them empirically validated
 - e.g. where is the evidence on non-linear NKPC, costs of inflation dispersion, ...?

Where to go from here?

- Framed another way:
 - Paper says don't take the NK model only in part
 - Take it on board fully (non-linear)
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- Should we do so without question?
 - Should we re-run all the horse races we ran within the simple linearized model, non-linearly?
 - Should we abandon NK ship, start from scratch?
 - Different papers, related critiques, different take-aways