The econometric grumbler looks for the confidence fairy

Discussion of "Does the confidence fairy exist?"
by Oana Fortuna, Roel Beetsma and Massimo Giuliodori

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Banco de España. June 06, 2016

In a nutshell

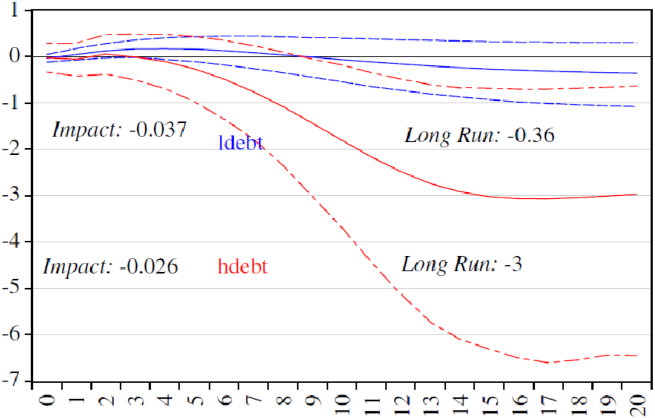
- The paper finds evidence against the main channel of the so-called expansionary austerity.
- In a few words, I like the paper and I buy the result.
- However...

  ... I of course have some “concerns”.
- These “concerns” are typical comments from a journal referee in search of the confidence fairy.

Comment 1: Debt sustainability

The confidence fairy may appear only when public debt is high

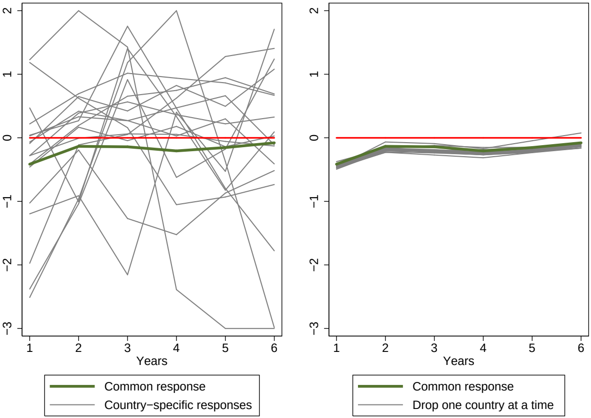
- Corsetti et al. (2012) and Ilzetzki et al. (2013).
- Local projections may be helpful here.



Comment 2: Country-specific heterogeneity

The confidence fairy may only exist in some faithful countries

- You can estimate country-specific responses with 144 observations.
- Local projections may be helpful here.



Comment 3: Predictability

The confidence fairy may be invisible to the econometrician

- The paper should show the predictability tests, which are standard in the literature — Hernández de Cos and Moral-Benito (2016).
- If debt dynamics can predict announcement shocks, debt must be included in the baseline specification .
- Local projections may be helpful here.

Table 3
The effect of a 1% of GDP CAPB shock in year $t = 2$ (%).

	Overall adjustments		Tax-based adjustments		Spending-based adjustments	
	IV (1)	OLS (2)	IV (3)	OLS (4)	IV (5)	OLS (6)
GLP controls	-0.82^{**}	-0.62^{***}	-3.35^{**}	-1.45^{***}	-0.50^{*}	-0.50^{**}
(s.e.)	(0.33)	(0.19)	(1.38)	(0.39)	(0.27)	(0.21)
Extended controls	-1.30	-0.41^{*}	-2.89^{*}	-1.30^{***}	-0.03	-0.03
(s.e.)	(0.98)	(0.25)	(1.62)	(0.46)	(0.43)	(0.28)

The table reports the estimated output effect of a 1% fiscal adjustment shock identified by the narrative record in the second year. Extended controls include lagged GDP growth, investment growth, debt-to-GDP, and consumer confidence as control variables while GLP controls include only lagged GDP growth as in Guajardo et al. (2014). All columns include country-specific effects and a set of time dummies.

Comment 4: Local Projections

Jordá (2005) may have the key that opens the fairy's hideout

- Local projections may prove to be helpful if you try to account for the grumbler's concerns:

  1. LP do not require assumptions regarding how the economy transitions from state-to-state, as well as the feedback of the shocks to the state.
  2. LP do not require that all variables enter all equations, so one can use a more parsimonious specification.
  3. LP do not constrain the shape of the impulse response function, so it is less sensitive to misspecification.

Other Comments

1. Standard errors clustered at the country level.
2. Why not business confidence?
3. Time dummies must be included in the baseline specification (Individual?).