

Discussion

“Fiscal Policy, Relative Prices
and Net Exports in a Currency Union”

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Fiscal policy and intra-Eurozone competitiveness

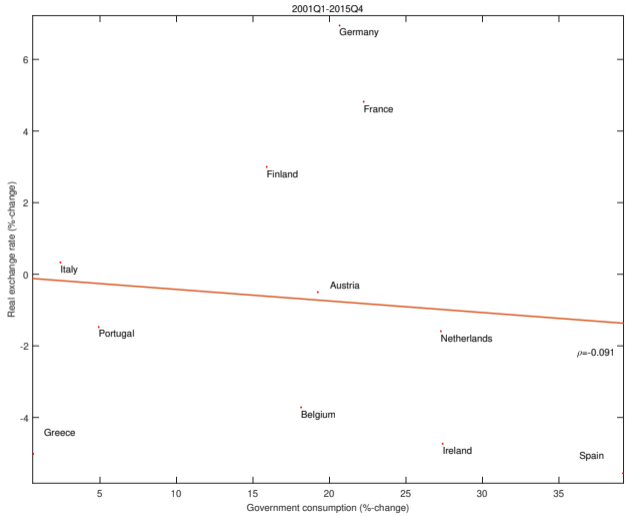
... some people have strong opinions

What Europe needs is austerity in the south and inflationary growth in the north to improve the competitiveness of the south and to structurally improve the current account imbalances.

Hans-Werner Sinn (2014)

Fiscal policy and intra-Eurozone competitiveness

... naive correlation doesn't show much



Overview

Research question:

What are the effects of fiscal policy on net exports, relative prices and expenditure switching?

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First things first

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- Authors dig deep into the data to get to the bottom of things

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Plan for this discussion

- Brief summary
- Few comments, mostly on the empirics

This paper: Empirics

Approach:

- Identify exogenous shocks to government spending and consumption taxes
- Estimate cumulative fiscal multipliers via local projections
- Augment this by industry-level regressions

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Findings:

- Both spending cuts and tax hikes raise net exports
 - mostly driven by fall in imports
- Spending cuts are deflationary
 - driven by non-traded goods prices
- Wages and prices in traded-goods industries react much less to spending cuts

This paper: Model

Approach:

- SMOPEC model of monetary union à la Galí/Monacelli (2005) with a number of extensions to capture the empirically-observed relative price movements
 - restricted factor mobility between sectors
 - strong home-bias in government purchases
 - distribution services for traded retail good

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Findings:

- Overall, model with extensions (!) can account for empirical evidence quite well
- However, mobility friction and home-bias lead to large output costs of current account correction through fiscal policy
 - might be worthwhile for policy to tackle these issues

1: Austerity vs. stimulus

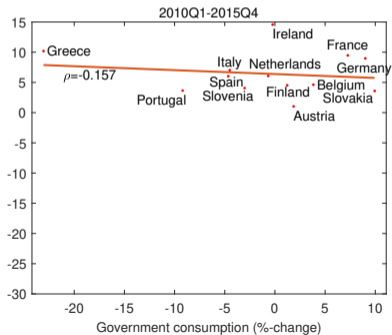
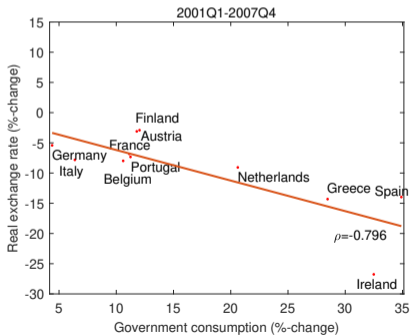
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- What if the world is non-linear?
→ e.g. if nominal wages are downwardly rigid (Schmitt-Grohé/Uribe, 2016)

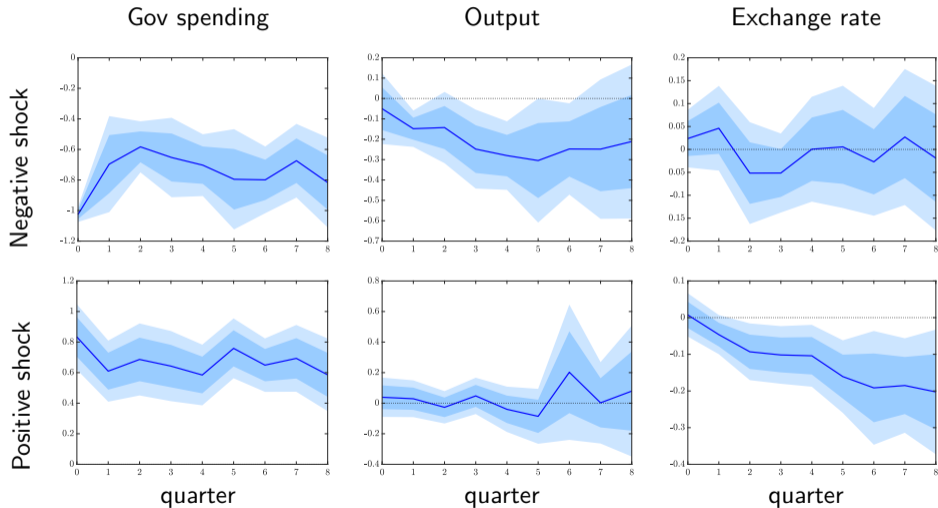
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1: Austerity vs. stimulus

Euro area: adjustment to fiscal shocks asymmetric (Born et al., 2019)

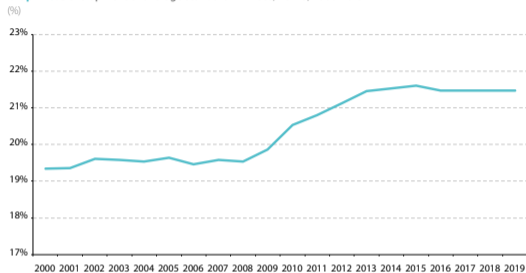


1: Austerity vs. stimulus

- Distinguishing between hikes and cuts might also help you understand the heterogeneous responses of traded and non-traded industries
- If the heterogeneity is coming from cuts, it might be differences in downward nominal wage rigidity
- Technically, given that you already have a two-stage approach, it might be as easy as including positive and negative shocks separately
 - cumulative multipliers might be an issue

2: Consumption tax variation

Graph 10: Development of average standard VAT rate, EU-28, 2000-2019



Source: DG Taxation and Customs Union.

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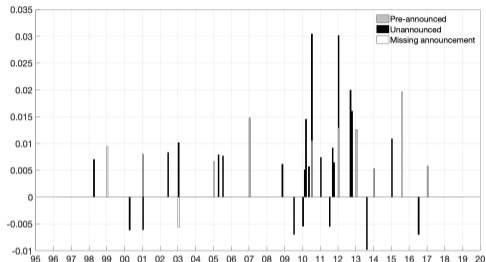


Figure 2: CONSUMPTION TAX CHANGES AND ANNOUNCEMENTS

- Consumption tax changes dominated by “permanent” hikes after Financial Crisis/Euro Area Sovereign Debt Crisis

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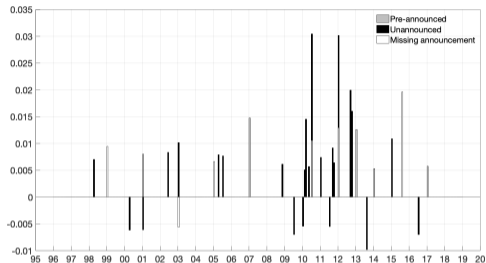
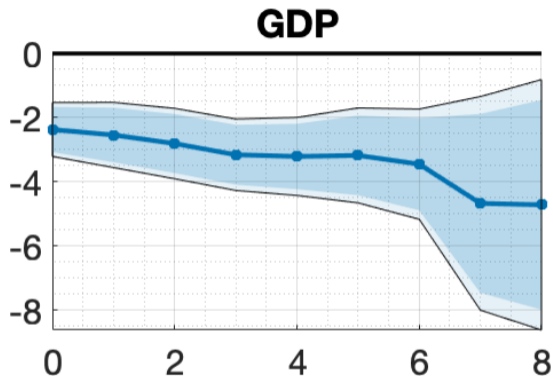


Figure 2: CONSUMPTION TAX CHANGES AND ANNOUNCEMENTS

- Consumption tax changes dominated by “permanent” hikes after Financial Crisis/Euro Area Sovereign Debt Crisis
 - this might be a very special time
 - and we know that fiscal multipliers depend on many things

2: Consumption tax variation



- This might also explain the large and persistent fall in GDP after a tax hike
- But would we expect the mirror image for a tax cut in Germany?

3: Forecasts in first stage

Table 1: FIRST-STAGE REGRESSION

	$\Delta \ln G_{i,t}$			$\Delta \tau_{i,t}$
	(1)	(2)	(3)	(4)
$F_{t-1} \Delta \ln G_{i,t}$	0.56 (0.06)	0.85 (0.04)		
$\Delta \ln G_{i,t-1}$	0.14 (0.04)		0.25 (0.04)	
$\Delta \ln G_{i,t-2}$	0.03 (0.04)		0.15 (0.04)	
$\Delta \tau_{i,t-1}$				0.17 (0.05)
$\Delta \tau_{i,t-2}$				-0.09 (0.05)
$\Delta \ln Y_{i,t-1}$	0.02 (0.04)		0.03 (0.05)	0.00 (0.01)
$\Delta \ln Y_{i,t-2}$	0.14 (0.04)		0.12 (0.05)	0.01 (0.01)
$\Delta u_{i,t-1}$	-0.34 (0.13)		-0.56 (0.14)	0.04 (0.02)
$\Delta u_{i,t-2}$	0.29 (0.12)		0.44 (0.13)	-0.04 (0.02)
R^2	0.51	0.44	0.40	0.09

- How large is the R^2 just including fixed effects?

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- How do IRFs look if estimated with shocks from specification (3)?
- If similar, could also run a quarterly specification without forecasts
- *Oxford Economics* has quarterly government consumption forecasts starting in the 1990s
→ see Born et al. (2020) for details

To sum up

- Very interesting paper
 - looking forward to reading future versions
- Three recommendations:
 - ▶ Look at potential asymmetries between cuts and hikes
 - ▶ Focus on government spending
 - you do that to a certain degree already
 - ▶ Maybe also consider a quarterly sample

References I

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