“Fiscal Policy” by Alan Auerbach

DISCUSSION BY VALERIE A. RAMEY

PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

OCTOBER 12, 2017

Alan talks about four important issues in fiscal policy

1. Fiscal rules
2. Potential for stabilization policy
3. Fiscal policy in a low-interest rate environment
4. Coordination between monetary and fiscal policy

My assessment of the U.S. evidence

1. Spending stimulus multipliers are probably less than one in most instances.
2. The evidence on infrastructure multipliers is mixed.
3. The strongest, most robust evidence is that tax cuts have the biggest multipliers.

Government spending multipliers

- On average aggregate multipliers are estimated to be just below unity.

- However, many point to Auerbach-Gorodnichenko's (2012) estimates, suggesting that multipliers are higher in recessions.

- Let's look more closely.

Spending Multipliers in Recessions and Expansions: Auerbach-Gorodnichenko (AG)

	Multiplier, cumulative over 20 quarters	
Specification	Recession	Expansion
AG baseline estimates	2.2	-0.3
AG, allowing G to change regimes	1.7	-0.3
AG specification but with no future growth in definition of state	0.7	1.8
Jorda method on AG data and specification	0.8	-0.6

Ramey-Zubairy (forthcoming JPE) Estimates for 1889 - 2015

- Multipliers are below 1 even in bad states
  - robust to bad states defined as high unemployment, NBER recession, AG definition, etc.
  - robust to using military news or Blanchard-Perotti identification.
- Multipliers are below 1 in the ZLB state for full sample.
- Multipliers are around 1.5 for a few horizons in the ZLB if we exclude WWII rationing.

Ramey-Zubairy Estimated Multipliers for the U.S. from 1889 - 2015

	Linear Model	High Unemployment	Low Unemployment	P-value for difference in multipliers across states
Military news shock				
2 year integral	0.66	0.60	0.59	HAC=0.954
	(0.067)	(0.095)	(0.091)	AR=0.954
4 year integral	0.71	0.68	0.67	HAC=0.924
	(0.044)	(0.052)	(0.121)	AR=0.924
Blanchard-Perotti shock				
2 year integral	0.38	0.68	0.30	HAC=0.005
	(0.111)	(0.102)	(0.111)	AR =0.070
4 year integral	0.47	0.77	0.35	HAC=0.001
	(0.110)	(0.075)	(0.107)	AR =0.031

Can we use individual and cross-state multiplier estimates as aggregate multipliers?

- Identifying exogenous shocks at the household or state level is often easier because of natural experiments.

- The micro- and state-level estimates often imply high MPCs (marginal propensities to consume) and high multipliers (1.5 to 2).

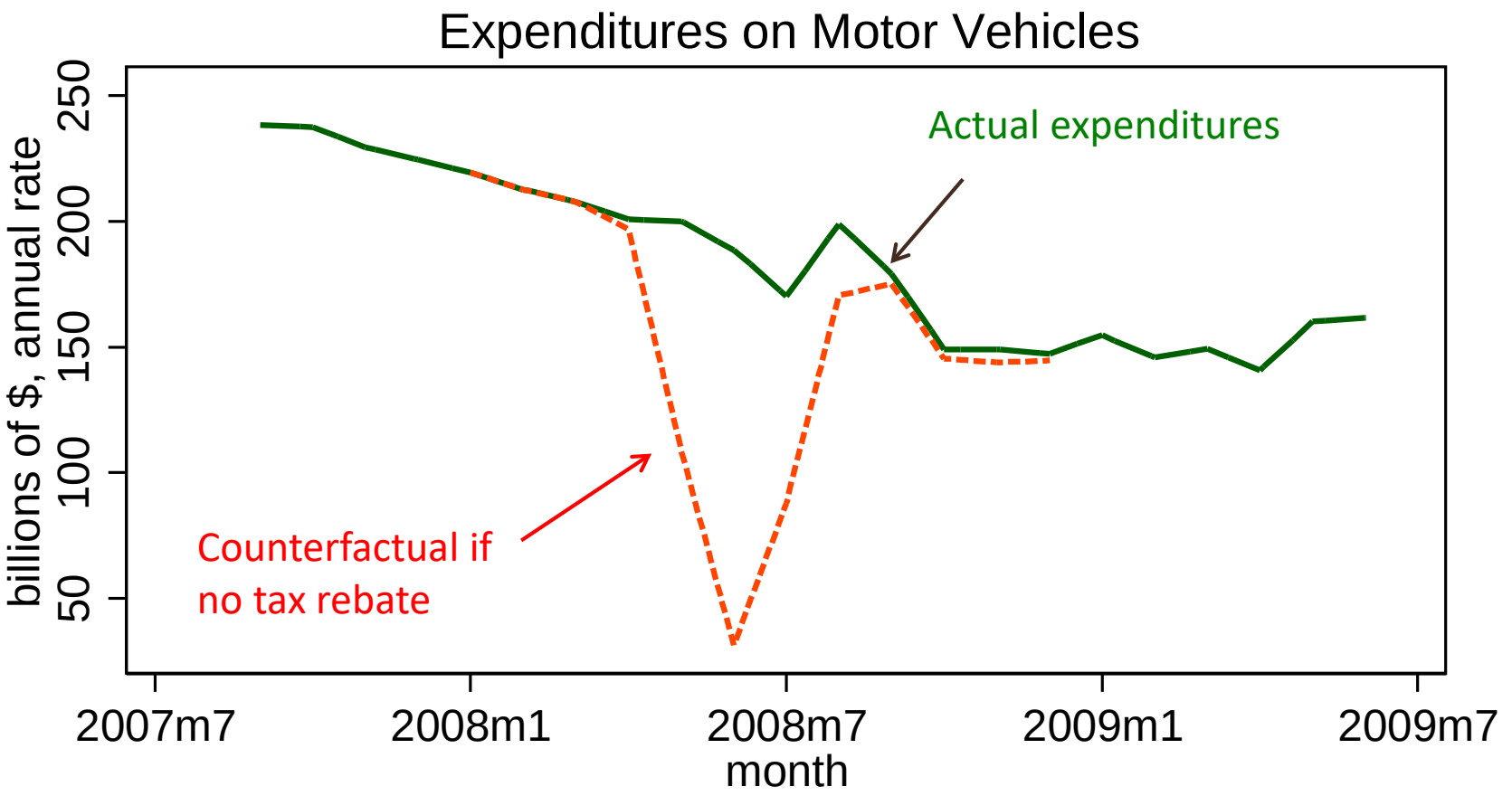
- Some have used New Keynesian theories to argue that these estimates are lower bounds on the aggregate multipliers, particularly during ZLBs (e.g. Chodorow-Reich(2017)).

Let's conduct two plausibility tests

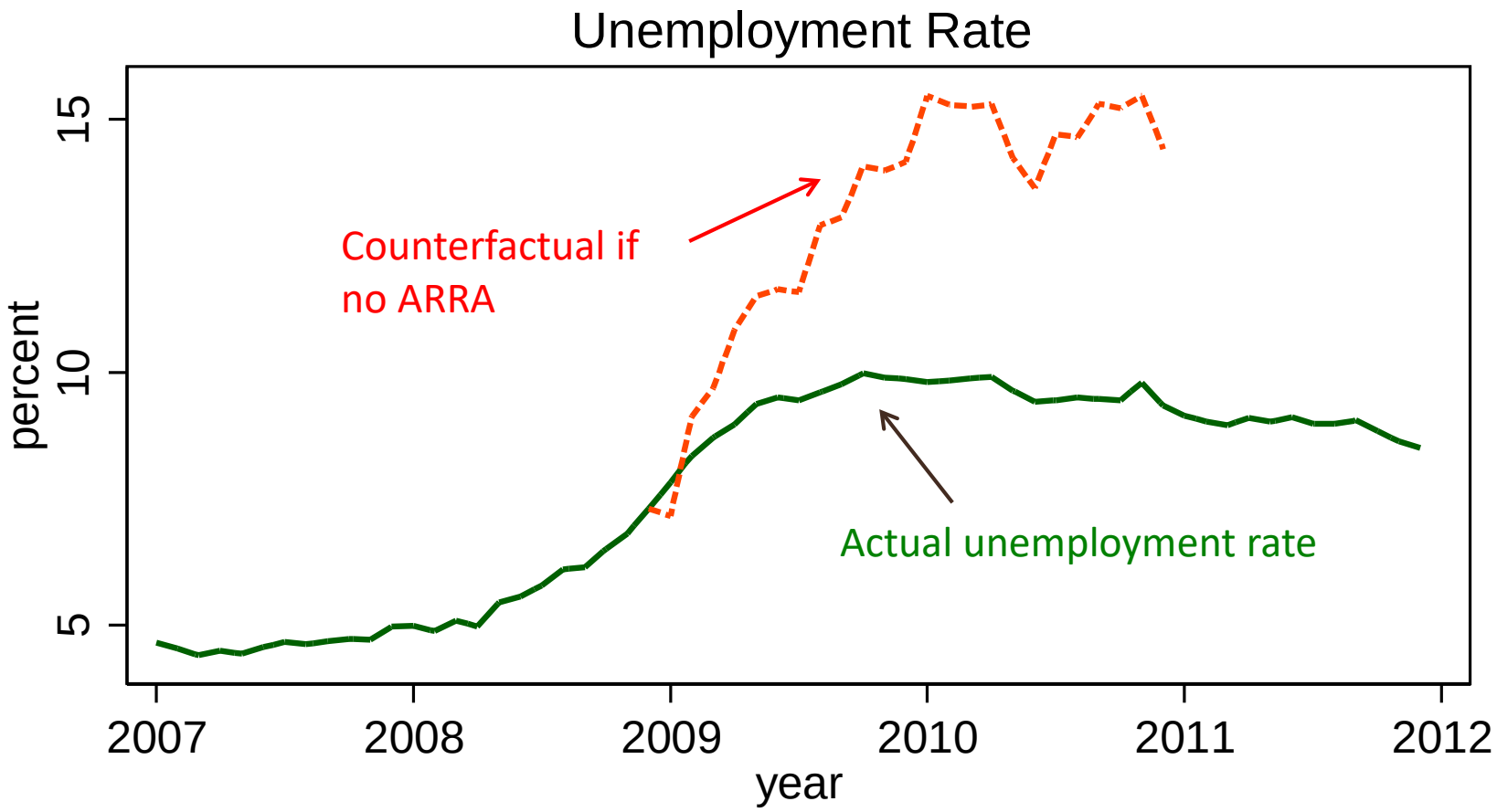
1. Sahm-Shapiro-Slemrod's (2012) plausibility test of Parker et al.'s individual-level estimates of marginal propensities to consume out of the 2008 tax rebate.

2. My plausibility test of Chodorow-Reich's contention that his cross-state ARRA estimates are lower bounds on the aggregate effects of the ARRA.

I apply the micro or state-level estimates to the aggregate to calculate the counterfactual of what would have happened with no stimulus.



Counterfactual estimates are based on Sahm-Shapiro-Slemrod (2012) calculations using Parker et al.'s (2013) MPC estimates of the effects of the 2008 tax rebate on motor vehicle spending.



The counterfactual estimates are based on Chodorow-Reich (2017) estimates of the effects of the ARRA on employment by month through December 2010.

Infrastructure multipliers

- There is fairly strong evidence that the building of the interstate highway system had important productivity effects (e.g. Fernald (1999)).

- The question is what is the multiplier on the current stock of potential infrastructure projects.

- This is an understudied area, but one useful recent contribution is Leduc and Wilson's (2013) analysis of the effects of highway spending over the last several decades.

Leduc-Wilson (2013) analysis of highway spending at the state level.

Tax rate changes

- Romer-Romer (2010) estimate that the multiplier on a tax rate change is -3.

- Follow up work by Mertens and Ravn finds similarly strong effects, between -2.5 and -3.

- Mertens and Ravn also split the Romer-Romer series into personal vs. corporate income tax rate changes. They find that on average corporate tax rate cuts have been revenue neutral!

Conclusions

- The most robust aggregate estimates of spending multipliers are those that lie below unity.
- Some multiplier estimates are higher, but they tend to be fragile.
- More work needs to be done on infrastructure multipliers before taking strong stands.
- The largest, most robust multiplier estimates are those for tax rate changes.