Quantifying the Fiscal Channel of Monetary Policy

Frederik Kurcz

Discussion by Michael Dobrew
European Central Bank

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Paper in a nutshell

Question

- How does (systematic) fiscal policy respond to and affect the strength of monetary policy?

Empirical

- Mixed-frequency proxy SVAR accounting for (i) systematic MP, (ii) time aggregation

$\Rightarrow$ Government spending flat, tax rate declines, real debt increases,

$\Rightarrow$ Unemployment and UI benefits increase

Theoretical

- IRF matching of two asset HANK model to estimate systematic fiscal rule
- Counterfactual policy exercise keeping average tax rate constant

$\Rightarrow$ Countercyclical fiscal rule ("Lean against MP")

$\Rightarrow$ Quantitatively important

Comments on empirical part I

Interpretation of IRFs - fiscal policy or business cycle?

- $G \rightarrow, \tau \downarrow, B \uparrow$ and $UI^b \uparrow$ consistent with reduction in output triggered by MP

$\rightarrow$ Is it active tax policy or business cycle driven tax reduction?

- Specification with Taxsim measure yields very similar IRFs

$\rightarrow$ What exactly is this exercise doing? (what is held constant, what keeps varying?)

$\rightarrow$ Do results imply all changes in taxes are due to active tax policy?

Direct comparison to Bouscasse, Hong (2023)

- Find that govt spending and transfers don't react, tax receipts fall
- Multitude of differences in empirical approach,
  e.g. Romer and Romer shocks, purging shocks from FP forecasts, Cholesky identification, detrending preserving govt budget constraint, ...

$\rightarrow$ What exactly is driving the differences in results?

Comments on empirical part II

Further thoughts

- Try specification including all fiscal instruments (G, τ, B, Tr)
- How to interpret monetary policy shocks at the ZLB? (similar results with 2008 as end date?)
- Does the mixed-frequency approach differ substantially from simple aggregation?
- Time-varying/regime-switching fiscal policy response?

Comments on theoretical part

Introduce additional model elements

- Unemployment response and UI benefits important in SVAR
- Adding price and wage indexation
- Uniform tax rate vs progressive taxation?
- Sticky information for hump-shaped output response?

Investigate further specifications for fiscal rule

- Fix G to replicate flat G response from empirical part
- Add UI benefits and (heterogeneous) transfers as fiscal instruments

Further thoughts

- How does fiscal rule shape direct vs indirect effects?
- Study distributional effects of fiscal rules
- Present counterfactual policy rule in terms of e.g. ”inflation elasticity”
- Very high interest rate smoothing?

Conclusion

- Very interesting work
- Highly important and policy relevant
- Technically very involved
- Looking forward to the next draft!