

Course of Fiscal Policy**Objective**

The objective of the course is to analyze in depth the effects of fiscal policy in closed and open economy models. Both empirical and theoretical aspects will be considered.

Outline

The knowledge of structural VAR techniques (to understand the empirical analyses) and of methods to solve dynamic stochastic general equilibrium model (do understand how the models work) is necessary for the students to follow the course with no problems. Students not familiar with the topics may consult chapters 2 and 4 of the book of Fabio Canova: *Methods for applied macroeconomic research*, Princeton, 2007, for reference.

Homeworks will require programming in MATLAB, working knowledge of this language is a prerequisite for successful performance in this class.

Pdf with lectures notes will be posted prior to the lectures on my home page together with sample programs.

References

Program

1) Empirical tools: Structural VARs and solutions to DSGE models. Homework 1

Canova, F. (2007) *Methods for Applied Macroeconomic Research*, Princeton University Press, Chapters 2 and 4.

2) What are the effects of fiscal shocks? Some empirical evidence

Blanchard, O. and Perotti, R (2002) An empirical characterization of the dynamic effects of changes in government spending and taxes on Output, *Quarterly Journal of Economics*, 117, 1329-1368.

Burnside, C., Eichenbaum, M. and J. Fisher (2004), Fiscal shocks and their consequences, *Journal of Economic Theory* 115, 89-117

Caldara, D. and C. Kamps (2007), What are the effects of Fiscal Policy shocks? A VAR based comparative analysis, ECB working paper 877.

Canova, F. and P. Pappa (2007), Price differential in Monetary Unions: The role of fiscal shocks, *Economic Journal*, 117, 713-737.

Canova, F. and P. Pappa (2006a), The elusive cost and the immaterial gains of fiscal restrictions, *Journal of Public Economics*, 90, 1341- 1414

Canova, F. and P. Pappa (2006b) Does it cost to be virtuous? The macroeconomic effects of fiscal constraints, in Clarida, R. and West (eds.) *NBER International Macroeconomic Annual*, MIT Press.

Chung, H. and Leeper, E. (2007) What has financed Government Debt?, University of Indiana, manuscript.

Edelberg, W., Eichenbaum, M. and Fisher, J. (1999) Understanding the effects of a shock to Government Purchases, *Review of Economic Dynamics*, 166-206.

Eichenbaum, M. and J. Fisher (2005), Fiscal policy in the aftermath of 9/11, *Journal of Money Credit and Banking*, 37, 1-22.

Favero, C. and Giavazzi, F (2007) Debt and the effect of fiscal policy, IGER Bocconi, manuscript.

Giannitsarou, C. and A. Scott (2006), Inflation Implications of Rising Government Debt, in L. Reichlin and West, K. (eds.), *NBER International Macro Annual*, MIT Press

Mountford, A. and Uhlig, H (2005) What are the effects of fiscal policy shocks, *Journal of Applied Econometrics*, 2009.

Pappa, P. (2008) The effects of fiscal policy: an international comparison, UAB manuscript.

Pappa, P. (2009) The effects of fiscal shocks on hours and wages, *International Economic Review*, 50, 217-244.

Perotti, R. (2004) Estimating the Effects of Fiscal Policy in OECD countries, CEPR working paper 168.

Perotti, R. (2007) In search of the transmission mechanism of fiscal policy, *NBER Macroeconomic Annual*, MIT Press.

Ramey, V. and Shapiro, M. (1998) Costly capital reallocation and the Effect of Government Spending, *Carnegie Rochester Conference on Public Policy*, 145-194.

Cardia, E (1997), Replicating Ricardian Equivalence tests with simulated series, *American Economic Review*, 87, 65-79.

Gale, W. and P. Orszag (2004) Budget Deficit, National Savings and Interest Rates, Brookings Papers on Economic Activity, 2, 101-210.

Parker, J. (1999) The Reaction of Household Consumption to predictable Changes in Social Security Taxes, American Economic Review, 89, 959-973.

Shapiro, M. and Slemrod, J. (2003) The consumer response to tax rebate, American Economic Review, 93, 381-396.

3) Presentations

i) Tax changes: a narrative approach (Romer, C. and D. Romer (2007a) The macroeconomic effects of tax changes, NBER working paper 13264, and (2007b) Do tax cuts starve the beast? The effects of tax changes on Government spending, NBER working paper 13548.

ii) Tax changes: Micro evidence (D., Parker J. and Souleles, N. (2006) Household expenditure and Income Tax Rebates of 2001, American Economic Review, 96, 1589-1610; Coronado, J., Lupton,

J., Shiner, L. (2005) The household spending response to the 2003 Tax cut: Evidence from survey data, Finance and Economic Discussion Series, 2005-32, Federal Reserve Board; Broda, C. and

ParKer, J. (2008) The impact of the 2008 Tax Rebates on consumer spending: preliminary evidence, mimeo.

iii) Debt dynamics and Inflation (Bohn (2005), The fiscal sustainability of US debt, CESifo, wp 1446;

Giannitsarou, C. and A. Scott (2006), Inflation Implications of Rising Government Debt, in L. Reichlin and West, K. (eds.), NBER International Macro Annual, MIT Press.

iv) Fiscal foresight (House, C. and Shapiro, M (2006) Phase-in Tax cuts and economic activity, American Economic Review, 96, 1835-1849; House and Shapiro, (2008, AER)).

4) What are the effects of fiscal shocks? Theories (RBC and New Keynesian)

Homework 2

Baxter, M. and King, R., 1993, Fiscal Policy in General Equilibrium, American Economic Review, 83, 315-334.

Finn, G.M., 1998, Cyclical effects of government employment and goods purchases, International Economic Review, 39, 635-657.

Aschauer, D. A., Is public expenditure productive?, 1989, Journal of Monetary Economics, 23, 177-200.

Braun, T., 1994, Tax disturbances and real economic activity in the postwar US, Journal of Monetary Economics, 33, 441-462.

Cipollone, P. and Rosolia, A., 2007, Social Interaction in High School: Lessons from an earthquake, American Economic Review, 97, 948-965.

Ludvigson C. S., 1996, The Macroeconomic Effects of Government Debt in a Stochastic Growth Model, Journal of Monetary Economics, 38, 25-45.

McGattan, E., 1994, The macroeconomic effects of distortionary taxation, Journal of Monetary Economics, 33, 573-601.

Pappa, E., 2009, The effects of fiscal shocks on employment and the real wage, International Economic Review, 50, 217-244.

Linneman, L. and Schabert, A., 2003, Fiscal policy in the neoclassical synthesis, Journal of Money Credit and Banking, 35, 911-930.

Ravn, M., Schmitt-Grohe, S and Uribe, M., 2007, Explaining the effect of government spending on consumption and the real exchange rate, NBER working paper 13328

5) Presentations:

i) Extensions 1: Non-separable utility (Bouakez, H. and N. Rebei, 2007, Why does private consumption rise after a government spending shock?, Canadian Journal of Economics, 40, 954- 979.

ii) Extension 2: Rule of thumb consumers (Gali, J., J.D. Lopez-Salido, and J. Valles, 2007, Understanding the effects of government spending on consumption, Journal of the European Economic Association, 5, 227-270.)

iii) Extension 3: GHH preferences (Monacelli, T and Perotti, R., 2008, Fiscal Policy, Wealth Effects and Markups, Bocconi University, manuscript.)

iv) Extension 4: Deep habits (Ravn, M., Schmitt-Grohe, S and Uribe, M., 2006, Deep habits, Review of Economic Studies.)

6) Fiscal and the labor market

- Bruckner, M. and E. Pappa, Fiscal shocks can increase unemployment: theory and evidence from OECD countries, mimeo UAB.
- Costain, J. Jimeno, J. and C. Thomas, "Employment fluctuations in a dual labor market," Bank of Spain
- Faia, E., Lechthaler, W. and C. Merkl, "Fiscal multipliers and the labour market in the open economy," Kiel Working Papers, (2010), No. 1592.
- Monacelli, T., Perotti, R. and A. Trigari, "Unemployment Fiscal Multipliers," Journal of Monetary Economics, 57, (2010), 531-554.
- Gomes, P., "Fiscal policy and the labour market: the effects of public sector employment and wages," mimeo LSE (2009).
- Ravn, M. and S. Simonelli, "Labor Market Dynamics and the Business Cycle: Structural Evidence for the United States," The Scandinavian Journal of Economics, 109, (2007), 743-777.

7) Fiscal policy predictability: Examples and consequences

- Auerbach, A and Slemrod, J., 1997, The economic effects of tax reform act of 1986, Journal of Economic Literature, 35, 589-632.
- Canova, F. 2009, Is there fiscal foresight?, manuscript.
- Hansen, L. and Sargent, T., 1991, Two difficulties in Interpreting Vector Autoregressions, in Hansen and Sargent (eds.), Rational Expectations Econometrics, 77-119, Westview Press, Boulder, Co.
- House C. and Shapiro, M., 2006, Phased-in Tax Cuts and Economic Activity, American Economic Review, 96, 1835-1849
- House C. and Shapiro, M., 2008, Temporary Investment Tax-Incentives: Theory with Evidence with Bonus Depreciation, American Economic Review, 98,
- Leeper, E, Walker, T and Yang, S.C., 2008, Fiscal Foresight: Analytics and Econometrics, manuscript, University of Indiana.
- Leeper, E, Walker, T and Yang, S.C., 2009, Empirical Analyses of Fiscal Foresight, manuscript, University of Indiana.
- Lippi, M. and Reichlin, L., 1993, The Dynamic Effects of Aggregate Demand and Supply Disturbances: Comment, American Economic Review, 83, 644-652.
- Lippi, M. and Reichlin, L., 1994, VAR analysis, Nonfundamental representations and Blaschke matrices, Journal of Econometrics, 63, 307-325.
- Martens, K and Ravn, M, 2008, The aggregate effects of Anticipated and Unanticipated US tax policy shocks: Theory and Empirical Evidence, EUI, working paper 2008/5
- Roberds, W, 1991 Implications of Expected Present value Budget Balance: Application to Postwar US data, in Hansen and Sargent (eds.), Rational Expectations Econometrics, 163-175, Westview Press, Boulder, Co.
- Souleles, N 1999, The response of household consumption to Income tax rebates, American Economic Review, 89, 947-958.
- Steigerwald, D. G., and Stuart, C., 1997, Econometric Estimation of foresight: Tax policy and Investment in the US, Review of Economics and Statistics, 79, 32-40.
- Yang, S.C., 2005, Quantifying tax effects under perfect foresight, Journal of Monetary Economics, 52, 1157-1568.
- Fernandez, J., Rubio, J., Sargent, T and Watson, M, 2007, Fernandez-Villaverde, J., Rubio-Ramirez, J., Sargent, T. and Watson, M., 2007, The ABC (and D) of structural VARs, American Economic Review, 97, 1021-1026.
- Quah, D. 1990, Permanent and Transitory Movements in Labor Income: An explanation for "Excess Smoothness" in consumption, Journal of Political Economy, 98, 449-475.

8) Fiscal policy at the time of crises: how big are the multipliers?

- Christiano, L., Eichenbaum, M. and Rebelo, S (2009) When is the Government spending multiplier large?, Northwestern University, manuscript.
- Feldstein, M. (2009) Rethinking the role of Fiscal policy, NBER wp 14684
- Cogan, J., Cwik, T., Taylor, J. and Wieland, V (2009), New Keynesian versus old Keynesian Government spending multipliers, CEPR working paper 7236

Grading

The grade will be based on homeworks, on class presentations on the topics listed below, and on a final short paper (max 10 pages) developing one of the topics discussed in the class.