Topics in Fiscal Policy
EUI, Advanced Macro, PhD 2017

Instructor: Axelle Ferrière, e-mail: axelle.ferriere@eui.eu.

Course Overview: This class will cover a range of positive and normative questions related to fiscal policy issues: what are the effects of a change in taxes, public debt, government spending? What should be the optimal plan for labor taxes, capital taxes, transfers, public debt, government spending? We will discuss models with a representative agent and with heterogeneous agents.
The general syllabus below is extremely large; in class, we will discuss a subset of it.

General syllabus:

1. Optimal fiscal plans with time-zero commitment

   (a) A warm-up: we review the well-known papers of Chamley and Judd and discuss their results on capital taxes; we use this as an opportunity to review the Primal Approach.

   · Chamley, C., *"Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives"*, Econometrica, 54, 3 (May 1986), 607-622.
   · Judd, K. L., *"Redistributive Taxation in a Simple Perfect Foresight Model"*, Journal of Public Economics, 28,1 (October 1985), 59-83.
   · Straub, L. & Werning, I., *"Positive Long Run Capital Taxation: Chamley-Judd Revisited"*, NBER Working Paper No. 20441, 2014.

   (b) Optimal responses of tax and public debt to shocks in models with a representative agent.

   - Complete markets:
     - With debt and labor taxes: Lucas, R. Jr. & Stokey, N. L. (1983), *"Optimal fiscal and monetary policy in an economy without capital"*, Journal of Monetary Economics, Elsevier, vol. 12(1), pages 55-93.
     - Adding capital taxes: Chari, V. V. & Christiano, L. J. & Kehoe, P. J. (1994), *"Optimal Fiscal Policy in a Business Cycle Model"*, Journal of Political Economy, University of Chicago Press, vol. 102(4), pages 617-52.
     - Adding endogenous government spending, adding ambiguity: Ferriere, A. & Karantounias, A. (2016 WP), *"Fiscal austerity in ambiguous times"*.
   - Incomplete markets
     - With debt and labor taxes: Aiyagari, S. R., Marcet, A., Sargent, T. J., and Seppala, Juha (2002): *"Optimal Taxation without State-Contingent Debt"*, Journal of Political Economy, 110, 1220-1254; Bhandari, A., Evans, D., Golosov, M. & Sargent, T. J. (2016 WP): *"Fiscal Policy and Debt Management with Incomplete Markets"*.

    - Adding maturities: Angeletos, G.-M. (2002), *"Fiscal Policy with Non-Contingent Debt and the Optimal Maturity Structure"*, Quarterly Journal of Economics 117:2
    - Adding capital taxes: Farhi, E. (2010), *"Capital Taxation and Ownership when Markets are Incomplete"*, Journal of Political Economy, 118 (5): 908-948.

(c) Optimal taxes and transfers with heterogenous agents.

- Complete markets: Werning, I. (2007), *"Optimal Fiscal Policy with Redistribution"*, The Quarterly Journal of Economics, Oxford University Press, vol. 122(3), pages 925-967.
- Incomplete markets:
    - With a new computational method: Bhandari, A., Evans, D., Golosov, M. & Sargent, T. J. (2016 WP), *"Taxes, Debts, and Redistributions with Aggregate Shocks"*.
    - With human capital: Gottardi, P., Kajii, A., & Nakajima, T. (2015), *"Optimal Taxation and Debt with Uninsurable Risks to Human Capital Accumulation"*, American Economic Review 105(11), 3443-3470.

2. Fiscal plans in Aiyagari models.

- Capital taxes:
    - Domeij, D. & Heathcote, J. (2004) *"On the Distributional Effects of Reducing Capital Taxes"*, International Economic Review, 45/2, p. 523-554.
    - Conesa, J. C., Kitao, S. & Krueger, D. (2009), *"Taxing Capital? Not a Bad Idea after All!"*, American Economic Review, 99(1): 25-48.
- The role of public debt:
    - Aiyagari, S. R., & McGrattan, E. R. (1998), *"The Optimum Quantity of Debt"*, Journal of Monetary Economics, 42(3): 447-469.
    - Floden, M. (2001), *"The Effectiveness of Government Debt and Transfers as Insurance"*, Journal of Monetary Economics, 48(1), 81-108.
    - Rohrs, S., & Winter, C. (2015), *Public versus private provision of liquidity: Is there a trade-off?*, Journal of Economic Dynamics and Control, 53: 314-330.
- Progressive taxes:
    - Heathcote, J., Storesletten, K., & Violante, G. (2014), *"Consumption and Labor Supply with Partial Insurance: An Analytical Framework"*, American Economic Review, Vol. 104(7), 2075-2126.
    - Ferriere, A., & Navarro, G. (2016 WP), *"The Heterogeneous Effects of Government Spending: It's All About Taxes"*.

- Dynamic lump-sum taxes:

  – Heathcote, J. (2005), *“Fiscal Policy with Heterogeneous Agents and Incomplete Markets”*, Review of Economic Studies, 72, p. 161-188.
  – Kaplan, G. & Violante, G. (2014), *“A Model of the Consumption Response to Fiscal Stimulus Payments”*, Econometrica, Vol. 82(4), 1199-1239.

3. Optimal fiscal plans without commitment

   - Optimal fiscal policy without commitment: Klein, P., & Rios-Rull, J.-V. (2003), *”Time-Consistent Optimal Fiscal Policy”*, International Economic Review, 44 (4),12171245; Klein, P., Krusell, P., and Rios-Rull, J.-V. (2008), *“Time-Consistent Public Policy”*, Review of Economic Studies, 75, 789808; Krusell, P., Martin, F. M. & Rios-Rull, J.-V. (2005 WP), *”Time-Consistent Debt’.*
   - Sovereign default.

4. Government expenditures: a positive analysis

5. Empirical work on taxes, government expenditures, public debt

Grading:

You will be asked to replicate some quantitative results (this can be handled in teams of maximum two students) plus to present a paper (20mn).