Discussion of "Fiscal Policy with Credit Constrained Households"

by W. Roeger and J. in't Veld

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1. **What are the effects of fiscal policy expansions when households are credit-constrained?**
2. **Does monetary policy matter?** More specifically, does monetary **accommodation** make fiscal policy more effective?
3. **Should governments cooperate (**i.e.: is a **global** fiscal stimulus desirable?**)**

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2. Tax shocks more effective when households are **credit constrained**
3. **Monetary policy** accommodation reinforces fiscal stimulus (CC households highly sensitive to variations in real interest rate)
4. Positive **spillover** effects of fiscal shocks, **global** fiscal stimulus more effective than uncoordinated policy actions

Contributions

- Build **two-region** DSGE model with household heterogeneity: Ricardian, non-Ricardian (liquidity constrained ROT), credit-constrained (impatient agent facing collateral constraints)

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- **Novelty**: combining RIC + ROT + CC to analyze **fiscal** policy issues
- Focus on **accommodative** monetary policy and **global** fiscal stimulus
- Main argument: CC households consume an increase in net income (as ROT) and are highly sensitive to variations in real interest rates

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Overall effect: $\uparrow C^c$. However, ROT crucial to generate $\uparrow C^{AGG}$ under sticky wages IRFs

Fiscal multipliers: a comparison with the literature

	EU	RoW	Global
Government consumption			
EU GDP	0.74	0.26	0.99
RoW GDP	0.09	0.96	1.04
Government consumption with monetary accommodation			
EU GDP	1.23	0.08	1.40
RoW GDP	0.04	1.48	1.52
Labour tax			
EU GDP	0.41	0.12	0.53
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EU GDP	0.60	0.05	0.68
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4. **Global** fiscal stimulus, monetary **accommodation:** largest gains: EA double, US almost double

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- **Caveat # 1**: response to fiscal stimulus with **accommodation** highly sensitive to nominal and real rigidities, inflation persistence, IES (see Forni and Pisani (2009))
- **Caveat # 2**: model cannot generate $\uparrow C_t^c$ and $\downarrow B_t^c$ at the same time. Hence may **overestimate** aggregate effects on C by construction (esp. under monetary accommodation!) Data

Modeling assumptions: Labor market specification

- Production function

$$Y_t^j (ucap_t^j K_t^j)^{1-\alpha} (L_t^j - LO_t^j)^{\alpha} U_t^{\gamma\alpha} K_t^{G(1-\alpha_G)}$$

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- How would results change under more traditional labor market structure?

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- Recent research (Pesenti (2008), Laxton and Pesenti (2007), Coenen et al. (2008)) has focused on effects of foreign detention of government debt

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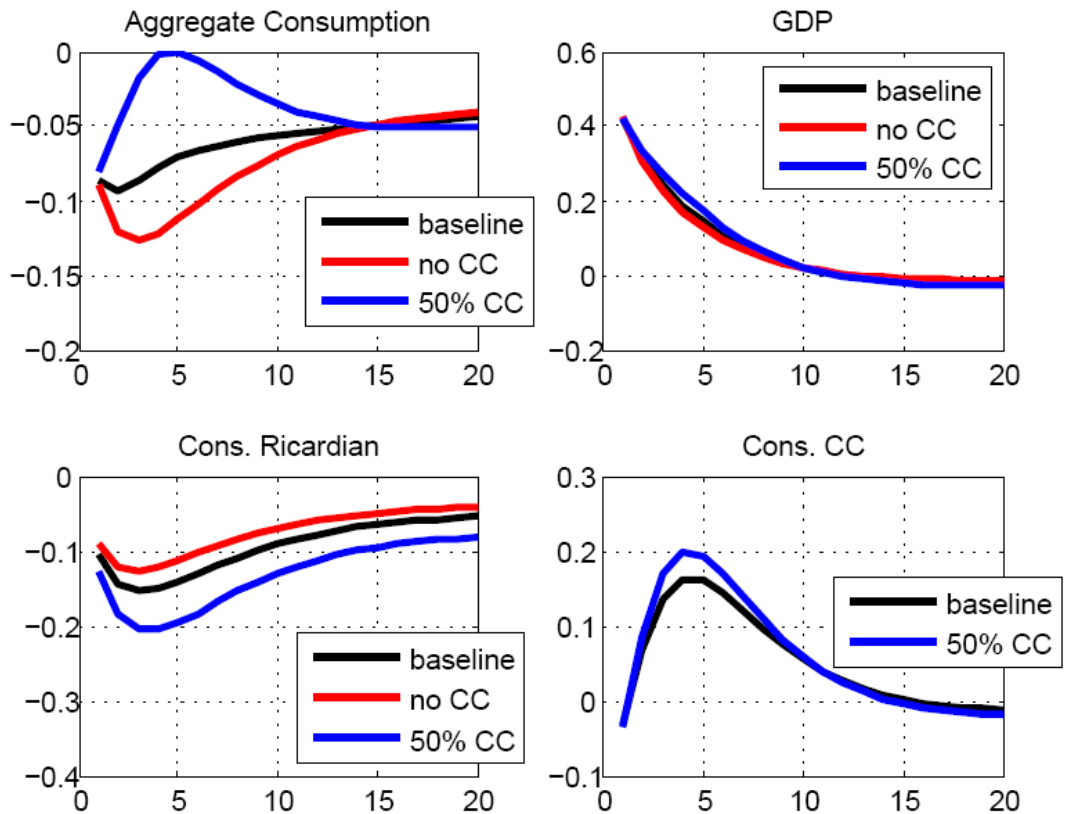
- Paper suggests that once (1) is achieved, countries have incentive to use fiscal policy, which in turn generates positive spillovers $\Longrightarrow$ implementability of (2) made easier

THE END

Effects of a US G shock: a two-country model with hh credit frictions

- Darracq-Pariès and Notarpietro (ECB wp # 972, 2008): two-country model with housing collateral, stylized fiscal policy



Back

US 2008 tax cut: empirical evidence

- Shapiro-Slamrod (2009): **2008** tax cut: U of Michigan Survey: *"Thinking about your (family's) financial situation this year, will the tax rebate lead you mostly to increase spending, mostly to increase saving, or mostly to pay off debt?"*

Table 1. Responses to 2008 Rebate Survey

	Number of Responses	Percent
Mostly Spend	447	19.9%
Mostly Save	715	31.8%
Mostly Pay Off Debt	1,083	48.2%
Will Not Get Rebate	212	
Don't Know, Refused	61	
Total	2,518	100%

Source: Survey of Consumers, February 2008 through June 2008.

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- Broda and Parker (2009): expenditure data for hh's who *did* receive the rebate: spending increase by *twice* as much among "mostly spent" vs "mostly save" or "mostly pay off debt"

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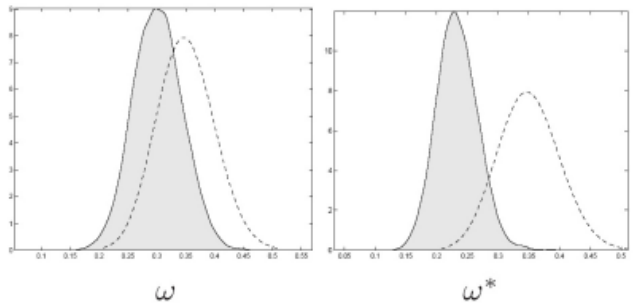
Identifying the share of credit-constrained hh's (Darracq-Pariès and Notarpietro (2008))

- Benchmark prior distribution (mean = 0.3)



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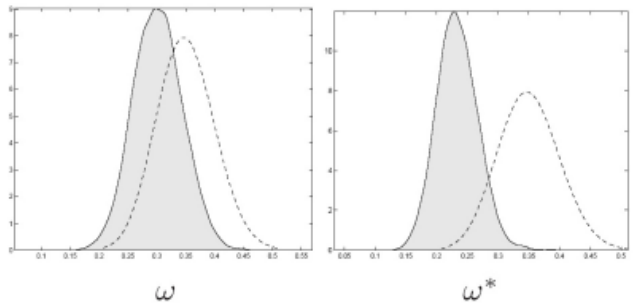

- Higher prior mean (= 0.5)