

COMMENTS ON SESSION 1 THE SHORT-TERM IMPACT OF FISCAL POLICY

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Comments on “Fiscal Multipliers and Fiscal Consolidations” by Ray Barrell, Dawn Holland and Ian Hurst and “Fiscal Multipliers: How Much Bang for the Buck?” by Glenn Follette and Byron Lutz

Let me start by thanking the organisers for inviting me and giving an opportunity to discuss these two papers. The first paper, “Fiscal multipliers and Fiscal Consolidations” by Ray Barrell, Dawn Holland and Ian Hurst presents an empirical evidence on fiscal multipliers based on simulations using the National Institute Global Econometric Model (NiGEM). An assessment of fiscal consolidation is performed for 18 OECD countries, focusing on actual fiscal programs for 2010-12 and on the expected fiscal actions for 201-20. A series of NiGEM simulations is used covering alternative horizons ranging from 2006-11 to 2015-27. An important feature of the authors’ approach is accounting for forward-looking behaviour of financial matters, via an implicit incorporation of the role of expectations. The key result is that a tighter monetary policy reduces output growth in the short run but – due to a lower debt stock – contributes to (sustainable) output growth in the long run.

The second paper, “Fiscal multipliers: How Much Bang for the Buck?” by Glenn Follette and Byron Lutz, presents a narrative evidence on fiscal multipliers for the U.S., based on the survey of the empirical literature and the FRB staff’s macroeconomic model. Assessment of the effectiveness of the U.S. fiscal policy in stimulating aggregate demand is conducted for a series of policy measures implemented between 1953 and 2010, including the 2008/2010 stimulus package. The main result is that the increases in the deficit helped boosting demand. Nevertheless direct multipliers were less than one, largely due to a reliance on tax cuts.

Let me comment on issues common to both papers. First, one can observe a large variation in the reported multipliers. The first paper attempts to relate the differences in multipliers to country-specific features (e.g., country size, degree of openness, and the degree of dependence on consumption and current income) and such variables as labour market flexibility and path-through of policies (e.g., a rise in VAT) into prices. The second paper shows that while direct multipliers in the U.S. are relatively low (by international standards), still there is an important variation of multipliers over time.

What can be learnt from such a variation in multipliers? Let me recall one relevant statement by Leeper (2010) regarding the variety of empirical estimates of fiscal multipliers: “One clear message emerges from (this) vast literature: estimates of multipliers are all over the map, providing empirical support for virtually any policy conclusion. The diversity of findings, often based on the same U.S. time series data, highlights the difficulties in obtaining reliable estimates of fiscal effects and points to the need for systematic analyses that confront fiscal policy’s complexities.” (p. 19).

It would be worth examining the underlying reasons of such diversity in multipliers, for example to investigate the role of methods (e.g., sample size, econometric technique, time period covered), the role of measurement of multipliers (expenditure/spending, short-/long-term, measures of dynamics) and the role of econometric specification (*i.e.*, the control variables) and the quality of studies used. Given the topic of this year’s workshop – “Fiscal Policy and Growth” – let me

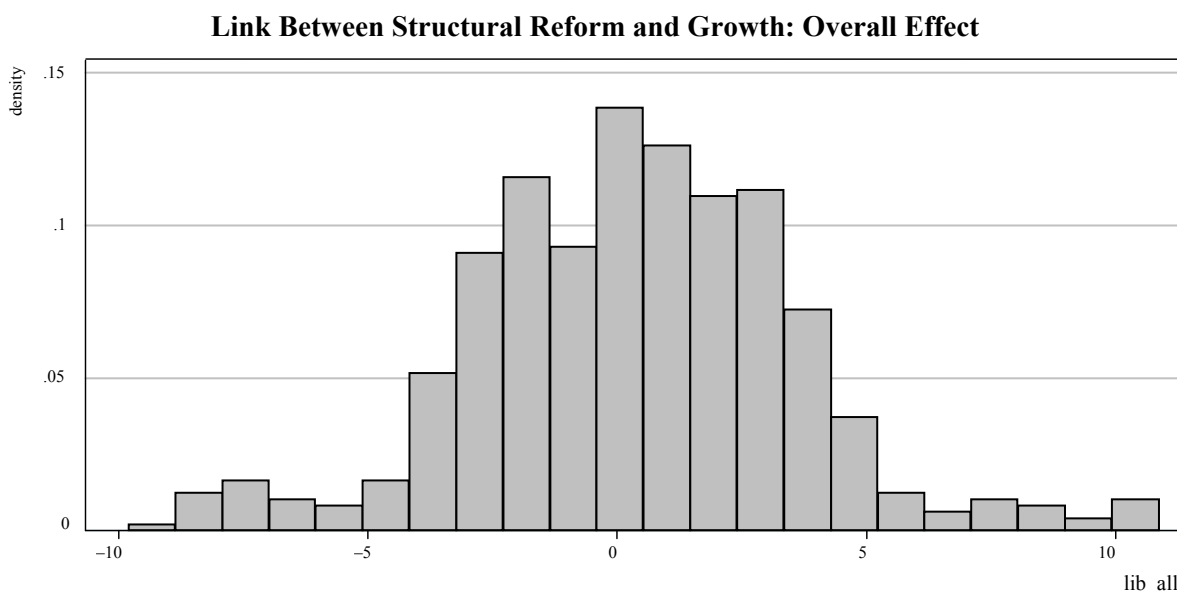
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illustrate whether some lessons could be taken from the existing literature on the issue of “Structural Reform and Growth”.

Based on the review of about fifty studies for transition economies, Babecký and Campos (2011) ask similar types of questions to those arising in the fiscal policy context: what is the impact of reform on growth? What are the short-run costs versus long-run benefits? A summary of the reform-growth nexus could be illustrated on the following three figures. Overall, considering the pool of available estimates of the effect of structural reform on growth (more precisely, *t*-statistics of the estimates, in order to allow for a comparability across studies which use different units of measurement, different specifications, etc.), Figure 1 shows the variety of estimates ranging from negative to positive ones, with the average effect of reform on growth being close to zero.

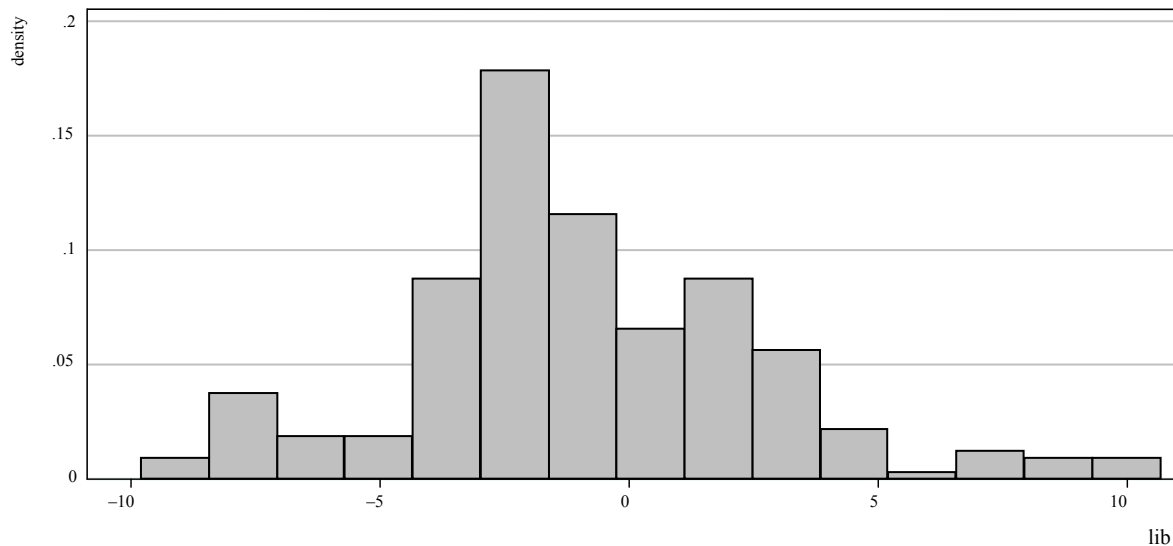
If one separates short-term and long-term effects, the histograms change. For example, in the short-run, the link between reforms and growth becomes negative (Figure 2), suggesting that the reforms are characterized by non-negligible real costs. These costs are offset over time, when benefits from implementing structural reform become materializing (Figure 3). Nevertheless, both Figure 2 and Figure 3 still demonstrate a large variety of the estimates.

Figure 1

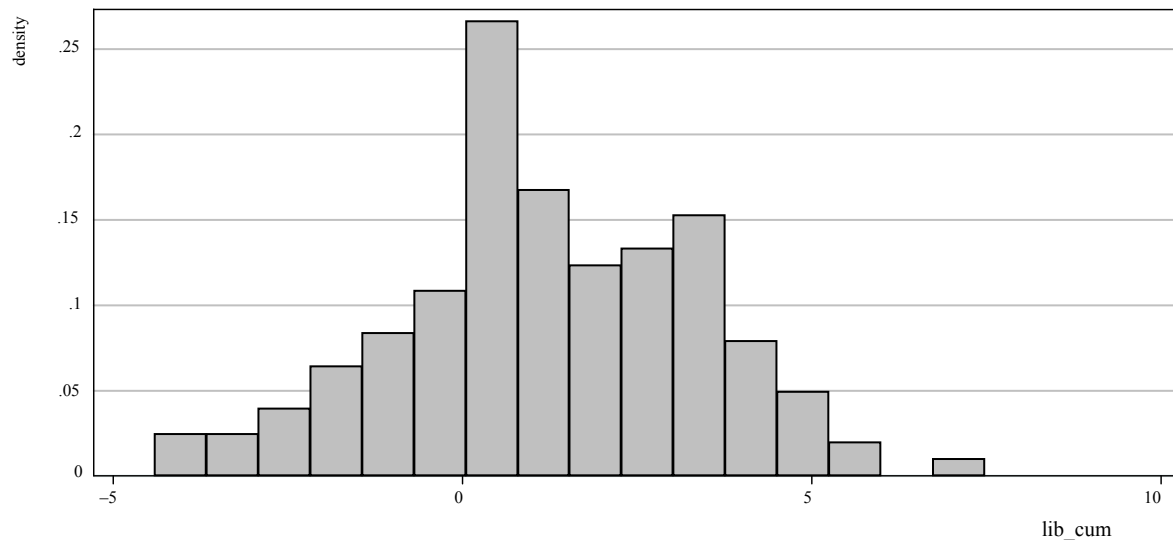


Note: Histogram of the *t*-statistics of coefficients of structural reforms on economic growth: 515 coefficients from the 46 papers (Figure 1 in Babecký and Campos, 2011).

This variation could be further explored employing the methods of quantitative review of literature – Meta-Regression Analysis (MRA), along with the above mentioned lines method-measurement-specification. Thus, it might be worth applying the MRA for a similar type of questions addressed in the fiscal policy – growth literature. Rusnak (2011) and Gechert and Will (2012) are two perspective applications of MRA to government spending multipliers. Apart from understanding the reasons which are behind differences in the estimate of multipliers, MRA can also help identifying the “best-practice” specification.

Figure 2**Link Between Structural Reform and Growth: Short-run Effect**

Note: Histogram of the t-statistics of coefficients of contemporaneous structural reforms on economic growth: 234 coefficients (Figure 2 in Babecký and Campos, 2011).

Figure 3**Link Between Structural Reform and Growth: Long-run Effect**

Note: Histogram of the t-statistics of coefficients of cumulative effect of structural reforms on economic growth: 276 coefficients (Figure 3 in Babecký and Campos, 2011).

Further directions for future research could include such issues as (i) the role of debt sustainability expectations (current analysis is largely done under assumption of constant risk premia); (ii) the impact of consolidation on risk premia; and (iii) fiscal stress testing (how changes in output growth would affect public finances).

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