The Investment Effect of Fiscal Consolidation

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discussion by Antonello D'Agostino

(European Stability Mechanism)

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European Stability Mechanism

The paper

- Quantify the impact of tax changes on:
  - Realised investments
  - Planned investments

- Datasets
  - Investments: micro level data from IFO investment survey and from the Economic and Business Dataset Center.
  - Tax shocks: narrative evidence derived from German tax legislation documents, (Romer and Romer (2010) approach).

- Mains results
  - Planned investments decrease by around 5.5% after a tax increase of 1%
  - Realized investments decline by around 4%.
  - Firms react both to current law changes and tax laws under discussion.

Discussion

- General Remarks
- Specific Remarks
- Additional points

Two General Comments

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- Main focus: tax shock should be related to corporate and business tax. In some cases the impact is not clear:
  - Ex. Consumption tax via VAT increase ➡ consumption increases ➡ sales increases ➡ investment increases.

Specific comments: Tax shock timing

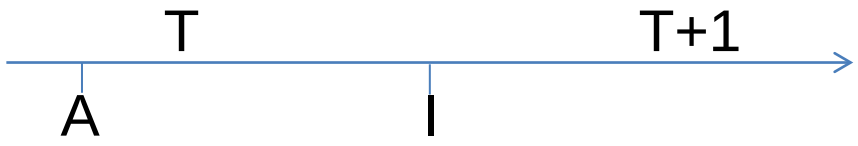
- Exact information timing about:
  - Introduction of initial draft to the Parliament
  - Publication of tax law
  - Implementation

- The Authors focus on exogenous tax shocks that are “announced and implemented” within the same time period.

Essentially it is an “unanticipated” tax shock

Specific comments: anticipated tax shock

- Question!
  - What about including also anticipated tax shocks?



The analysis could suffer of an omitted variable bias!

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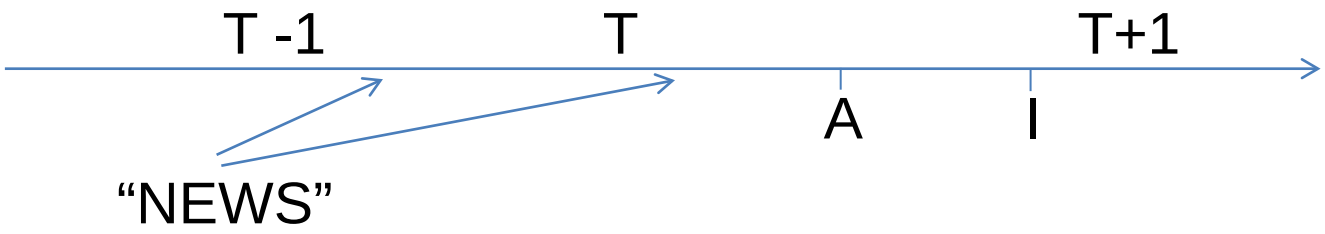

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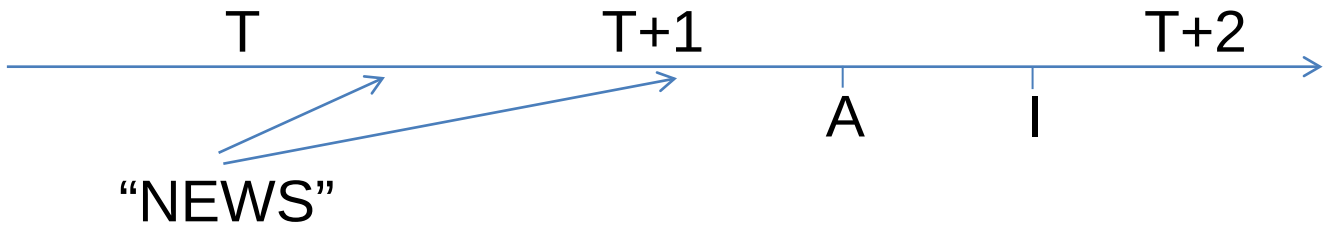

- Testing strategy: regress investments at time t on shocks at time t+1
- Tax shocks at time t+1 are function of the information set at time t

$$\tau_{t+1} = f(\mathrm{I}_t, \mathrm{I}_{t+1})$$

Specific comments: Anticipation Effect

- Proposed testing strategy:

  - Identify the exact timing of the first discussion of the law (which may take place in the previous period or current year) - “news shock”.

  - Control for the potential impact of anticipated tax shock at time t.

  - Run a regression using: anticipated shocks, unanticipated shocks and the series of “news shocks”.

Planned Investments

- Regression based on biannual time series built up with the Autumn and Spring survey
  - $\Delta \ln(PI_{2010,1)} = \ln\left(PI^{2010}_{2010,S}\right) - \ln\left(PI^{2010}_{2009,A}\right)$ Spring 2010
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  - $\ln\left(PI^{2010}_{2010,S}\right) - \ln\left(PI^{2010}_{2009,A}\right) =$
    $fe^{4}_{1} + fe^{5}_{2} + fe^{6}_{3} + re^{6}_{4} + re^{6}_{5} + re^{6}_{6} + re^{6}_{7} + re^{6}_{8} + re^{6}_{9} + re^{6}_{10} + re^{6}_{11} + re^{6}_{12}$

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- The autumn component is less volatile than the spring one.
- The biannual time series mix two different stochastic processes.
- This introduces a seasonal component.

- Suggestion: run two separate regressions.

Additional Points

- Threshold on the size of the shock
- First difference of investments
- Possible endogeneity bias
  - HP filtered GDP
  - Sale growth at time t
- Control variables
  - Liquidity constraints

Thank You!