COMMENT TO
"CROSS-COUNTRY SPILLOVERS FROM FISCAL CONSOLIDATIONS"
BY ANTOINE GOUJARD

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1 Introduction

The monetary policy seems to have achieved historical limits in its wide-ranging use of tools around the world. Although there have been significant differences in timing since the very beginning of the Great Recession, the central bank balance sheets of advanced economies have experienced an unprecedented expansion. The fiscal policy, however, has not been subject to the same consensus, following dissimilar paths depending upon which side of the Atlantic or the English Channel is considered.

One of the most controversial issues is that regarding the extent of the fiscal multipliers. As is well-known, the academic and policy-makers interest was fuelled by a box published in the October 2012 World Economic Outlook of the IMF; the alarm was the systematic downward bias in the fiscal multipliers assumed by the GDP growth forecast modellers compared to the actual (and higher) ones during 2010-2011. At the same time, some frustrating results coming from the intense fiscal consolidation processes carried out in the Eurozone added a real world ingredient to the discussion.

The paper "Cross-country Spillovers from Fiscal Consolidations", by Antoine Goujard, perfectly fits the current, intense debate on the effectiveness of the fiscal policies. The aim of the author has been to provide empirical estimates of the spillover effects coming from fiscal consolidations on the domestic economic activity and transmitted through the trade exchanges. The author has used panel data econometrics and offered additional robustness checks.

This comment is structured as follows. First, I summarise the main assets and contributions of the paper. Second, I shortly discuss the main issues arising from the reading of the paper, with some of them seen as further research. Finally, some minor and technical comments are offered.

2 Main assets and contributions of the paper

The paper by A. Goujard (2014), titled "Cross-country spillovers from fiscal consolidations", is clearly placed at the centre of the current discussion on fiscal multipliers. Some reasons support its bearing in this context, namely, the scope of the sample (in terms of both the time and geographical dimension of data), the use of standard methodologies (making easier its connection with the previous literature), and the widely battery of results offered.

Particularly, the main contributions of the paper are the next ones:

- A comprehensive discussion of the effects of fiscal consolidations across borders is presented. The econometric estimates not only focus on the impact on the real domestic output of trading partners but also pay attention to the growth of variables related to bilateral trade, employment and other components of the aggregate demand such as private consumption and investment.
- As said before, the methodological strategy has followed the standard patterns. This can be interpreted as a signal of technical competence for obtaining sound enough empirical results. At

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the same time, his econometric findings can be then appropriately contextualised in the previous literature.

- The author has also built new measures of trade-weighted fiscal spillovers and provided a number of robustness checks regarding different trade weights, econometric estimators and alternative sets of control variables.
- The rationale for explaining the empirical results within determined frameworks (flexible exchange rates, currency union, etc.) has been carefully elaborated.

3 A constructive discussion of the results

Next, I shall summarise the main concerns arising from a further interpretation of the empirical results and some questions with reference to the general approach of the paper as well. In a sense, part of my comments can be seen as potential extensions to be considered if useful. In other cases, I have elaborated some ideas using Goujard (2014) as motivation.

3.1 The estimates of cross-country fiscal multipliers are relatively huge

The central estimates for the impact of foreign fiscal shocks on domestic GDP growth are much higher than one would expect. For example, the author finds that "a fiscal consolidation in export market of 1 percent of GDP on average is associated with a decrease in domestic growth of 1.5 percentage points". In fact, this particular value can be classified as the minimum threshold in the battery of estimates because other fiscal spillover effects reported may well exceed 3 per cent of GDP (for instance, those regarding spending cuts in non-fixed exchange regime).

These figures are extraordinarily striking, especially when they are compared to the conventional fiscal multipliers estimated for domestic fiscal shocks. The World Economic Outlook of the International Monetary Fund (2010) reports an average value of around 0.5 in a sample of 15 advanced economies over the period 1979-2009. Even with the reconsideration of the debate, launched by Blanchard and Leigh (2013) in the aftermath of the Great Recession, the estimates for domestic fiscal multipliers are in a range of 0.9-1.7.

A convincing explanation of such as high impacts of foreign fiscal consolidations on trade partners is necessary in Goujard's paper. I would then suggest a more extensive use of the existing literature (for example, Auerbach and Gorodnichenko, 2013) and of the works in progress on the topic (for instance, some of the papers presented at the ECB Conference "Heterogeneity in currency areas and macroeconomic policies") in order to support your view. I guess the previous references could provide not only an implicit backing to his estimates in terms of similar values but also, and more importantly, a rationale about why fiscal spillover effects are relatively higher than one would expect at first sight.

3.2 The non-Keynesian effects of fiscal consolidations have been ignored

Despite the fact that the author recognises that fiscal consolidations may have positive effects on economic activity through lower interest rates (the so-called non-Keynesian effects), I have missed a more explicit treatment of them. Even within the cross-country environment featuring this paper, the non-Keynesian effects may well still matter. In this sense, note the extraordinarily high sensitivity of spreads in sovereign debt of some countries in the Eurozone when doubts about the fiscal sustainability of other countries emerge (Caporale and Girardi, 2013). In other words, successful episodes of fiscal consolidations positively impact not only on the domestic interest rates but also on those of other countries that, because of a number of (mainly institutional) reasons, are associated with.

In principle, the central specification determined in the paper (expression 3) contains time dummies being intended to control for the interest rate channel. But the intuition behind such interpretation is far from being straightforward. By contrast, the option chosen by Beetsma *et al.* (2006) and pointed out by the very author in the footnote 8, deserves a further reconsideration.

3.3 The interactions with the monetary policy should have been taken account

Recent papers have theoretically emphasised the links between the fiscal shocks across borders and the monetary policy rules and financial markets as well. See, for instance, the contributions by Bénassy-Quéré (2006) and Cooper *et al.* (2014). The conduit through which monetary and financial shocks and developments may affect GDP growth usually takes the equilibrium wages and interest rates (see my previous comment) as key variables.

However, the paper by Goujard has dismissed this possibility. Obviously, the translation of theoretical results to empirical articles is always a challenging task and this may be the case. But a range of alternative approaches (dummies, subsamples, structural breaks when monetary policies rules are modified) are available and the interested reader might very possibly miss a more explicit analysis of money in the estimates of fiscal spillovers.

This circumstance is highlighted by the fact that there are two big and clearly differentiated areas in terms of monetary policy rules (the Eurozone vs the US), and it is widely accepted that the effectiveness of fiscal policy is strongly conditioned by the mandate of the central bank.

3.4 Symmetry in the reasoning: what about expansionary fiscal shocks?

This point is more a reflexion than a criticism. Clearly, the paper by Goujard (2014) adopts the view of analysing to what extent contractionary fiscal shocks affect economic activity in trading partners. However, it could be very interesting to assess how symmetric are the results if instead of fiscal consolidations the governments are embarked in fiscal stimuli. Not in vain, a significant part of the current discussion in the policy arena pivots on the idea of turning fiscal austerity into a more expansive stance of the fiscal policy.

The question then would be: what is the fiscal multiplier of expansionary fiscal policies in the trading partner economies in terms of domestic activity? The high values achieved when fiscal consolidations are at place (and commented above) are still valid (obviously with the opposite sign) after changing the fiscal policy orientation? I obviously recognise that we would be talking about a completely different paper but the issue is extremely relevant nowadays from a policy view.

An additional challenging extension along this line would consist of investigating the impact of real spending and tax policies on the economic activity of trading partners, without constraining the scope of analysis to expansionary vs contractionary fiscal policies. At a given moment in time, each economy is affected by the fiscal consolidations carried out by some of its trading partners but, simultaneously, by the expansionary policies adopting in other countries. The extent of the net effect on the domestic economic activity becomes therefore a very realistic description of what is actually happening in the real world.

3.5 *Opposite fiscal policies simultaneously in the Eurozone?*

Extending the previous comment, a reasonable policy option to outweigh the depressing effects of fiscal consolidations of highly indebted countries in currency unions would entail a looser fiscal stance in economies without problems of fiscal sustainability. In the European context, this would imply that meanwhile the Southern countries are involved in cutting their public deficits, other Member States such as Germany, Austria or Finland should adopt a more expansionary fiscal stance.

The key underlying idea behind this argument is that there is a link between the deficits and the surpluses in the Eurozone, basically in terms of current account balances. But this relatively accepted statement is far from being formally proved. As Wylopsz (2010) has discussed, the issue is that all the Eurozone countries compete among them and with the rest of the world; and the fact that the lack of exchange rate adjustments in the Eurozone has led to current account imbalances with opposite signs cannot be used as proof that countries like Germany or Austria has built their external financial position on the basis of Southern countries deficits. Rather, a significant part of the surpluses is rooted in productivity gains and wage moderation, with substantial, similar implications on their commercial relationships with the rest of the world. Consequently, it does not make sense to call for reductions in German competitiveness to ease Southern European countries.

Beyond this "external" argument, an additional and even more relevant issue arises in order to deactivate this symmetric approach based on the combination of fiscal policies with different signs. I am referring to the fact that, under this corrective scenario, some governments (precisely those with stronger fundamentals to support economic sustainability) should be forced to modify their inter-temporal decisions in favour of more consumption and less savings. Though the excess of savings can be seen as inefficient in the short-term, some considerations regarding aging population may back the generation of optimal surpluses in the long run.

4 Minor comments

- With lags of the dependent variable among the regressors, the Anderson-Hsiao dynamic panel data estimator should offer the central estimates of the paper, instead of pushing them into the background as robustness checks.
- Given the availability of long enough time series (1978-2011), it would have been appropriate to check whether the variables are I(0) or I(1) and, if this is the case, whether co-integration analyses may improve the quality of estimates.
- SURE estimates could be also reasonable. In fact, it is likely to find out contemporaneous correlations across countries, which conveniently exploited might increase the efficiency of the results (using Zellner-type estimator).
- When comparing the action-based and the cyclically-adjusted fiscal spillovers, the paper arrives at completely different results. The author guesses that this may be caused by endogeneity problems and uses the action-based measure to instrument the cyclically-adjusted measure. Then, the estimates appear aligned and compatible. Maybe I am wrong, but it seems to me an absolutely trivial and not very informative approach.

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