COURSE SYLLABUS   **12M013**

Fiscal Policy

3 ECTS   **TERM 2**   **ELECTIVE COURSE**

Professor

Prof. Davide Debortoli

Prerequisites to enroll

None.

Overview and objectives

The goal of the course is to study the macroeconomic effects of fiscal policies. We will review the main empirical results and workhorse theoretical approaches to understand the effects of government spending, the role of automatic stabilizers, taxes and government debt, as well as the interactions between fiscal and monetary policy and the role played by financial frictions and household heterogeneity.

Course outline

Below is an outline of the topics that will be covered, together with a (tentative) list of references for each topic. Additional references will be provided during lectures.

Topic 1: Empirical Evidence on the Fiscal Multiplier

Empirical approaches to quantify fiscal multipliers. How large is the fiscal multiplier? Does it depend on the type of fiscal policy (taxes vs expenditure)? Does it depend on the underlying economic circumstances (Booms vs Recessions, Open vs Closed economy, etc.)?

Alesina, A., C. Favero, and F. Giavazzi (2019): "Effects of Austerity: Expenditure-and Tax-Based Approaches," Journal of Economic Perspectives 33 (2), 141-62.

Auerbach, A. J. and Y. Gorodnichenko (2012): "Fiscal Multipliers in Recession and Expansion," *NBER Chapters* in: Fiscal Policy after the Financial Crisis, 63-98, National Bureau of Economic Research.

Barnichon R., D. Debortoli and C. Matthes (2021): "Understanding the Size of the Government Spending Multiplier: It's in the Sign", *The Review of Economic Studies*, forthcoming.

Blanchard, O. and R. Perotti (2002): "An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output," *the Quarterly Journal of economics* 117 (4), 1329--1368.

Ilzetzki, E., Mendoza, E. G. and Végh, C. A. (2013): "How big (small?) are Fiscal Multipliers?," *Journal of Monetary Economics,* 60, 239–54.

Mountford, A. and Uhlig, H. (2009): "What are the Effects of Fiscal Policy Shocks?.," *Journal of Applied* Econometrics, 24, 960-992.

Nakamura, E. and J. Steinsson (2014): "Fiscal Stimulus in a Monetary Union: Evidence from U.S. Regions," *American Economic Review*, 104 (3), 753-92.

Ramey, Valerie A. (2016): "Macroeconomic Shocks and Their Propagation," *Handbook of Macroeconomics*, Elsevier, vol. 2, 71-162.

Ramey, Valerie A. (2019): "Ten Years after the Financial Crisis: What Have We Learned from the Renaissance in Fiscal Research?," *Journal of Economic Perspectives*, 33 (2): 89-114.

Topic 2: Fiscal Policies, Debt Dynamics and Inflation in Business Cycle Models

Dynamics effects of government spending and taxation in the real business cycle model. Ricardian Equivalence and Crowding-Out. Lump-sum taxes vs distortionary taxes. Fiscal policy in the New-Keynesian model. The role of household heterogeneity, liquidity traps and currency unions.

Baxter, M. and R. G. King (1993): "Fiscal Policy in General Equilibrium," *The American Economic Review*, 315-334.

Bilbiie, F. O., T. Monacelli and R. Perotti (2013): "Public Debt and Redistribution with Borrowing Constraints," *The Economic Journal*, 123 (566), F64–F98.

Farhi, E. & Werning, I., 2016. "Fiscal Multipliers: Liquidity Traps and Currency Unions" in: J. B. Taylor & Harald Uhlig (ed.), *Handbook of Macroeconomics*, edition 1, volume 2, chapter 0, pages 2417-2492, Elsevier.

Galí, J., J. D. López-Salido, and J. Vallés (2007): "Understanding the Effects of Government Spending on Consumption." *Journal of the European Economic Association* 5 (1), 227-270.

Woodford, Michael (2011): "Simple Analytics of the Government Expenditure Multiplier." *American Economic Journal: Macroeconomics*, 3 (1): 1-35.

Topic 3. Fiscal Sustainability and Fiscal–Monetary Interactions

How to measure fiscal sustainability. Theories on debt sustainability. The role of inflation. Coordination between fiscal and monetary policies.

Blanchard, Olivier. 2019. "Public Debt and Low Interest Rates." *American Economic Review*, 109 (4): 1197-1229.

D'Erasmo, P., E.G. Mendoza and J. Zhang (2016): "What is Sustainable Public Debt?", in *Handbook of Macroeconomics*, ed. by J. B Taylor and H. Uhlig, ch. 32, vol. 2, 2493-2597.

Leeper, E.M. and C. Leith (2016): "Understanding Inflation as a Joint Monetary-Fiscal Phenomenon", *Handbook of Macroeconomics*, vol. 2, ch. 30, p. 2305-2415.

Sims, C. A, (1994): "A Simple Model for Study of the Determination of the Price Level and the Interaction of Monetary and Fiscal Policy", *Economic Theory,* 4(3): 381-399.

Topic 4. Optimal Fiscal Policy

Optimal capital- and labor- income taxation. Optimal debt policies. Commitment vs Discretion.

Benigno, P., and M. Woodford (2012): "Linear-Quadratic Approximation of Optimal Policy Problems," *Journal of Economic Theory* 147 (1), 1-42.

Chamley, C. (1986): "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives," *Econometrica*, 54(3), 607–22.

Chari, V., and P. J. Kehoe (1999): "Optimal fiscal and monetary policy," in *Handbook of Macroeconomics*, ed. by J. B. Taylor, and M. Woodford, vol. 1, chap. 26, pp. 1671–1745. Elsevier.

Debortoli, D., R. Nunes, and P. Yared (2017): "Optimal Time-Consistent Government Debt Maturity," *The Quarterly Journal of Economics*, 132(1), 55-102.

Judd, K. L. (1985): "Redistributive Taxation in a Simple Perfect Foresight Model," *Journal of Public Economics*, 28(1), 59–83.

Ljungqvist, L., and T. J. Sargent (2004): Recursive Macroeconomic Theory, 2nd Edition, vol. 1, Chapter 15, The MIT Press.

Lucas, R. J., and N. L. Stokey (1983): "Optimal fiscal and monetary policy in an economy without capital," *Journal of Monetary Economics*, 12(1), 55–93.

T.J. Sargent (2011) "U.S. then, Europe now", Nobel lecture, working paper NYU

Straub, L. and I. Werning (2020): "Positive Long-Run Capital Taxation: Chamley-Judd Revisited," *American Economic Review*, *110*(1), pp.86-119.

Required activities

There will be problem sets, which are intended to put at work the ideas introduced in class. Students are highly encouraged to discuss these exercises to detect difficulties and to develop their expertise in solving them. The students will make a 20min presentation of a selected topic at the end of the course.

Evaluation

Problem sets 30%

Presentation 20%

Final exam 50%

Competencies

☐ To (be able to) communicate with determination and in the English Language, the results and implications of the required analytical study using a language that the receiver can relate to.

☐ To possess and understand the knowledge that provides a basis or opportunity to be original in the development and / or application of ideas, often in a research context.

☐ To identify and apply the insights of the theory, the models, and the analytical tools of modern economy to its global dimension.

☐ Understand and apply the economic theory of macroeconomic models and financial markets.

☐ To understand and apply the quantitative methods used to solve complex problems of the economy.

☐ To evaluate, with theoretical and quantitative instruments, the complex realities of the economy to understand the way it works.

Learning outcomes

☐ Applies econometric techniques for an applied analysis of financial market policies.

☐ Applies numerical calculation methods and simulation techniques for macroeconomic problems and design of financial policy evaluation.

☐ Empirically characterizes relevant phenomena from the macroeconomic point of view.