Discussion of:
Exchange rate regimes and fiscal multipliers
by *Born, Juesses and Mueller*

Domenico Giannone

Université Libre de Bruxelles – ECARES and CEPR

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The paper

Fiscal multiplier depends on the exchange rate:

- Reduced form model: panel VAR
  - Flexible exchange rate: 1.2
  - Fixed exchange rate: 0.75
- Structural model: DSGE model calibrated to match reduced form evidence
  - Difference across regimes is due to real interest rate effects on consumption rather than exchange rate effects on net exports

The empirical Results

	GDP		Net Export		REER		Consumption		Real Int. Rate	
	Peg	Flex	Peg	Flex	Peg	Flex	Peg	Flex	Peg	Flex
Reduced form	1.25	0.75	<>	+	+	-			-	+
Structural model	1.10	0.80	<>	<>	+	+	0.2	-0.1	-	+

Key mechanism: monetary policy less accommodative under free floating

Difference across regimes are explained by real interest rate effects on consumption rather than exchange rate effects on net exports

How does the model matches this facts?
- low trade elasticity
- 1/3 of households are not allowed to smooth consumption

The model does not explain the well established evidence of exchange rate depreciation and the increase of net export under flexible exchange rate
Monacelli and Perotti, 2010; Corsetti et al, 2011,…

Comparison with other studies

	GDP	
	Peg	Flex
Reduced form	1.25	0.75
Structural model	1.10	0.80
Corsetti et al	1	<>
Ilzetzki et al.	>1	<>

The new result:

   positive multiplier under flexible exchange rate

The mechanism:
- Monetary policy is less restrictive than in the Mundel-Fleming model
- Low trade elasticity.

Alternative mechanism: spending reversal
   Corsetti et al, 2011

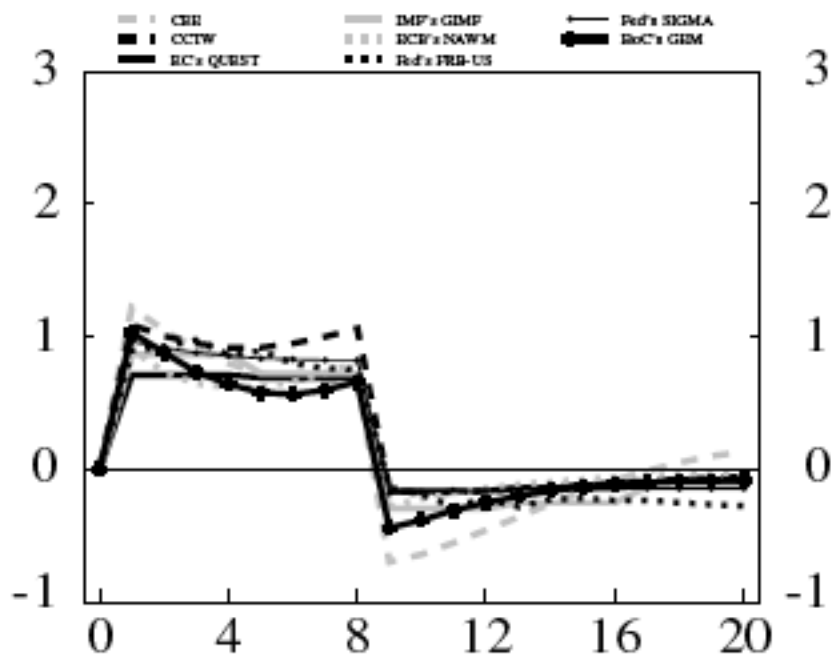More reasonable and matches results from a wide range of alternative model
   Coenen et al. 2011

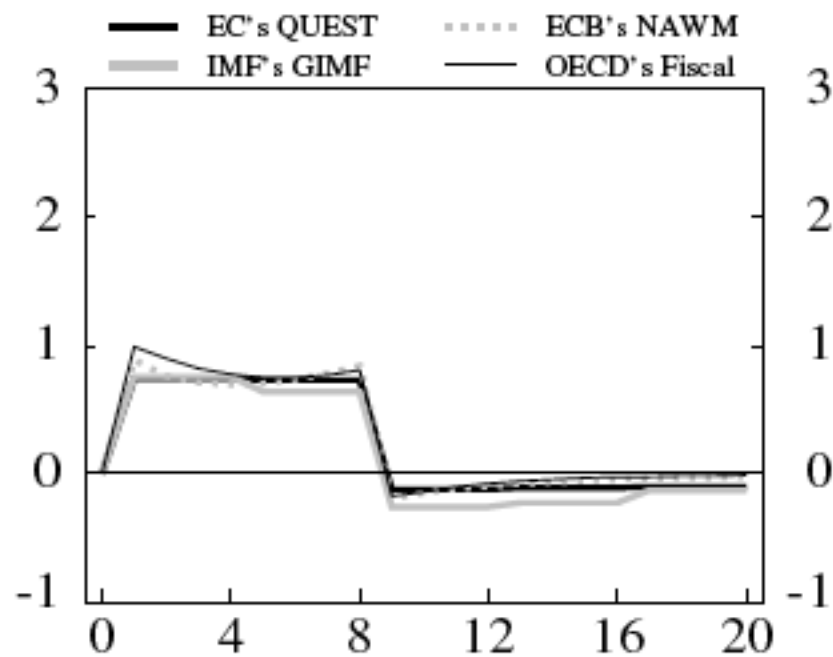# Effects of Fiscal Stimulus in Structural Models,

Coenen et al, 2011
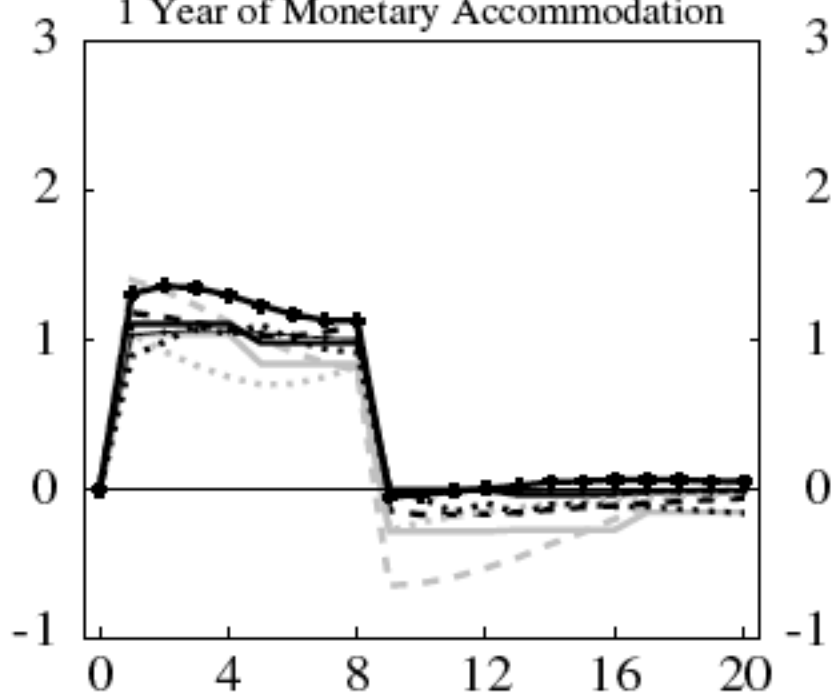
United States
No Monetary Accommodation

Legend: CBE, CCTW, EC's QUEST, IMF's GIMF, ECB's NAWM, Fed's FRB-US, Fed's SIGMA, BoC's GEM

Europe
No Monetary Accommodation

Legend: EC's QUEST, IMF's GIMF, ECB's NAWM, OECD's Fiscal

1 Year of Monetary Accommodation

1 Year of Monetary Accommodation

Comparison with other studies

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Corsetti et al	1	<>	-	<>	+	-	-	<>	+?	-?
Ilzetzki et al.	1.5	<>	-	-	-	+	+	<>	-	+

Comparison with other studies

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Ilzetzki et al.	1.5	<>	-	-	-	+	+	<>	-	+

What explains the differences?

- Quarterly versus annual data?
  - Gernot would say NO! (Mueller, JMBC 2012)
- Fiscal foresight?
  - Please check! No additional variable should help forecasting (see Giannone and Reichlin, 2008)
  - My prior: NO! (see Ramey-Perotti debate!!)

- **Alternative explanations: the methodology is inherently non robust!!**
  - Contrary to monetary policy, fiscal policy cannot be characterized by single instrument and simple linear rules!
  - Results are very sensitive to estimation method, pre-treatment of data and data mining

Data treatment and model estimation

- Panel VAR estimated by OLS on detrended data
  - VAR in levels is more robust (Sims, Stock and Waton, 1990)
  - OLS are inconsistent
    - Alternative: mean group estimation (Pesaran et al., 2010)

- VAR coefficients are assumed to be the same across a variety of countries with different economic structur
  - New Zealand and US
  - Belgium and Germany
  - Fixed exchange rate in Germany since 99. Accommodative policy!

  - ✓ Check homogeneity by reporting country specific results.
    Use priors to mitigate parameter uncertainty
    (Doan, Litterman and Sims, 1982; Giannone, Lenza and Primiceri, 2011)
  - ✓ Why not pooling Impulse Responses?

- Time series properties are very heterogeneous.
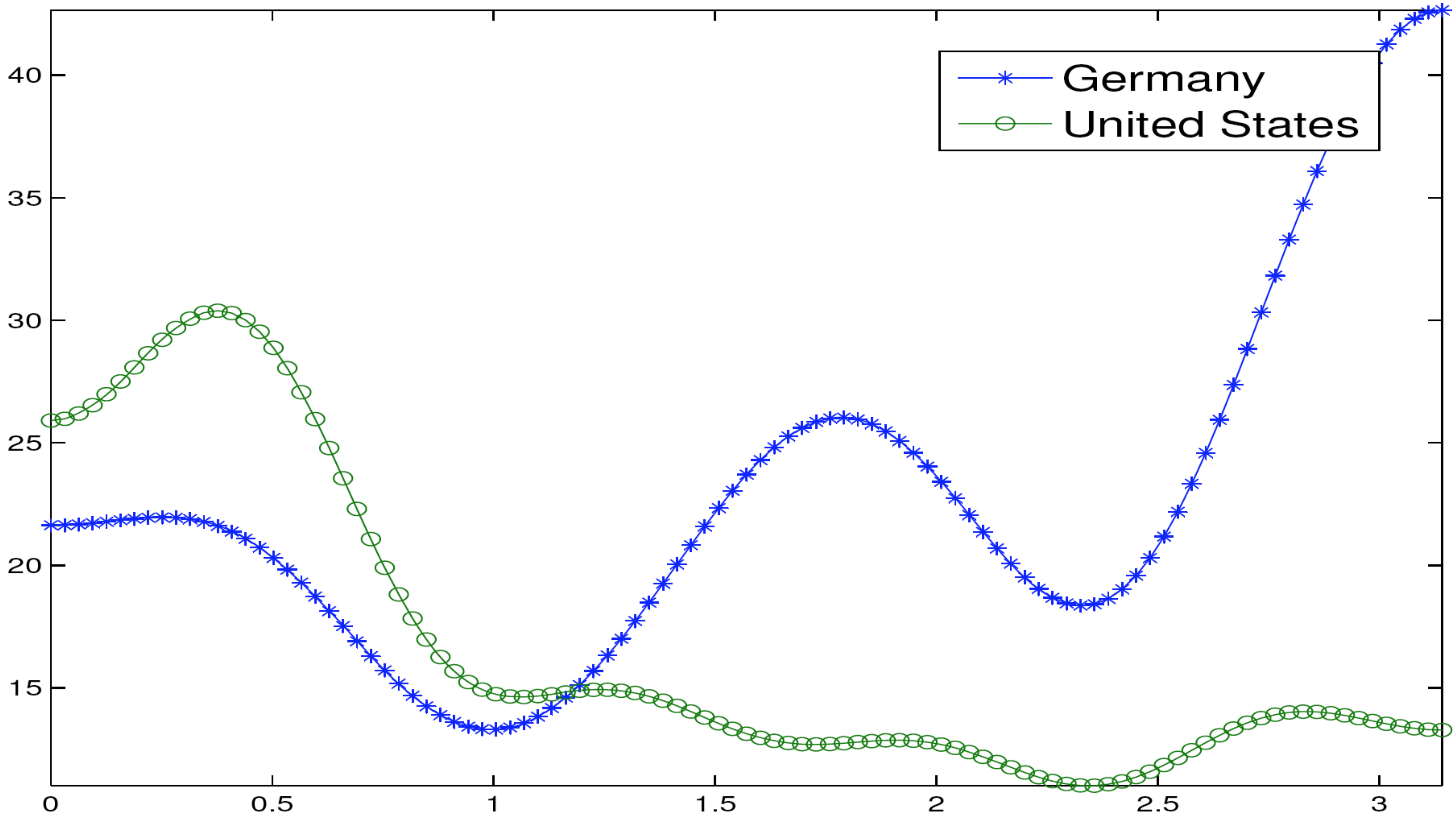   Heterogeneity and reliability of quarterly data

Heterogeneity and reliability of quarterly data

- ## The spectral density of GDP growth
  - ### US versus Germany

  (Source, Business Cycles in the Euro Area, Giannone, Lenza and Reichlin, 2010)

  Pooling Impulse Responses could mitigate the problem.

  - Requires homogeneity only of the responses to the government shock!

Conclusions

I strongly encourage you to read the paper!
- Fascinating and policy relevant topic
- Interesting and reasonable story/results
- Intellectually stimulating
  - You can make the economic models tell many stories often contrasting
- But not enough empirical discipline/identification
  - You can also make the data tell too many contrasting stories

- Still unable to track the transmission of fiscal policy

- Establishing robust facts is the priority!

- Long way to go, but hopefully the literature will converge, as for monetary policy shocks.