Discussion of
Seemingly Irresponsible but Welfare Improving Fiscal Policy at the YLB: The Role of Expectations

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This Paper

This paper in a nutshell

- Krugman et al. (1998): "If the central bank can credibly promise to be irresponsible it can bootstrap the economy out of the [liquidity trap] trap"
- This paper: If the government can be credibly promise to be irresponsible it can prevent the ZLB from ocurring

This Paper

- Framework: Basic NK model with ZLB constraint, lump sum taxation, one-period bonds, and one aggregate demand shock
- Two policy instruments:
  - nominal interest rate i_t (function of inflation)

$$i_t = \max[-\rho, \phi_\pi \pi_t] \tag{1}$$

  - primary surpluses $\hat{s}_t$ (function of debt levels)

$$\hat{s}_t = \phi_s \hat{b}_{t-1} \tag{2}$$

  which govern the evolution of the real debt stock

$$\underbrace{\hat{b}_t}_{\text{Real debt stock}} = \underbrace{\beta^{-1}\hat{b}_{t-1} + \beta^{-1} b \left(\hat{i}_{t-1} - \pi_t\right)}_{\text{Rollover and refinancing cost}} - \underbrace{\hat{s}_t}_{\text{Primary surplus}} \tag{3}$$

This Paper

- Combining fiscal rule with the l.o.m. for gov't debt yields

$$\hat{b}_t = \underbrace{\left(\beta^{-1} - \psi_s\right)}_{\equiv\delta} \hat{b}_{t-1} + \beta^{-1} b \left(\hat{i}_{t-1} - \pi_t\right) \tag{4}$$

- As in Leeper (1991), this implies conditions for distinct determinate equilibria

Fiscal policy \ Monetary Policy	Active	Passive
Passive	$\delta < 1, \phi_\pi > 1$	$\delta < 1, \phi_\pi < 1$
Active	$\delta > 1, \phi_\pi > 1$	$\delta > 1, \phi_\pi < 1$

  - PF/AM: Negative demand shocks offset by lower nominal rates.
  - AF/PM: Negative demand shocks offset by wealth effect b/c higher real value of debt.

This Paper

- This paper: What if fiscal policy is not just *under-reactive* to increases in debt levels ($\phi_s < (\beta^{-1} - 1)$), but actively *de-stabilises* debt levels ($\phi_s < 0$)?
- In calibrated model, super-active fiscal policy (sAF/PM)
  - improves welfare relative to PF/AM when accounting for ZLB (not true for AF/PM)
  - can eliminate ZLB episodes if interest rates are pegged ($\phi_\pi = 0$)
- But less effective with cognitive discounting, lower debt levels, longer-term debt
- Compared to Krugman et al. (1998), super-active fiscal policy
  - does not just tolerate deviations from target but actively worsens them
  - turns out to not be irresponsible after all, but unclear whether time consistent

Comments

Overall: Very nice paper

- Careful discussion of fical ? monetary polcy mix
- Highlights the role of expectations
- Nice discussion of policy mixes and historical experiments
- Very well explained intuition

Main comment: Interplay between *symmetric* policy rule, lump sum taxes, and commitment/expectations

Comments

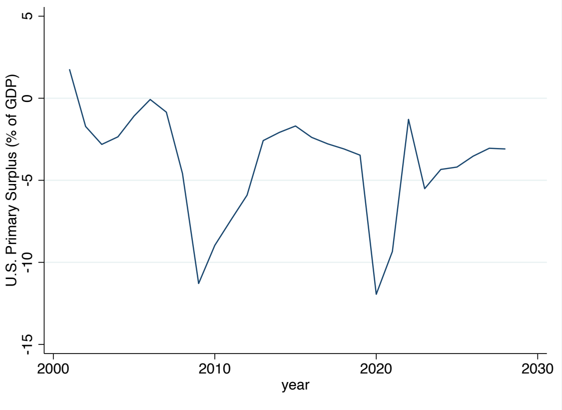

Figure: U.S. Primary Surplus

– Fiscal policy does not seem very symmetrical. "Super-active austerity" seems implausible

Comments

- Fiscal policy does not seem very symmetrical. "Super-active austerity" seems unrealistic.
- Probably because taxes are distortionary.
- This is not just a matter of realism but
  - creates commitment issues
  - creates *inflationary bias* (akin to the deflationary bias of the ZLB)
- If you want to abandon FIRE in some way to discuss expectations, this seems more relevant

Additional Comments

- Despite being in the title, cognitive discounting shows up quite late
- Formalizing the time consistency of policies might help with the credibility
- Parameter Robustness?
  - E.g., NKPC slope $\kappa \approx 0.17$ seems high and drives the pass-through to inflation
  - For comparison, Hazell et al. (2022) estimate $\kappa = 0.0062$
- What would happen if you throw supply shocks into the mix?
  - negative (adverse) supply shock: $\pi \uparrow \rightarrow \hat{b} \downarrow$
  - with super active fiscal policy, $E(\pi) \downarrow$ - higher volatility?

References I

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