

12M013

Fiscal Policy

3 ECTS

Overview and Objectives

The goal of the course is to study fiscal policy in a macroeconomic context, using dynamic equilibrium models. We study how to tax, who to tax, and when to tax. We discuss issues of efficiency, countercyclical policy along the business cycles, when to issue debt and what kind of debt. Automatic stabilizers. These issues are all crucial to the understanding of macroeconomics in general and, in particular, in the current context where the fiscal stance of several countries leads to a lot of uncertainty. We study these issues in dynamic equilibrium models, study issues of fiscal sustainability, and interactions between fiscal and monetary policy and empirical measurements of effects of taxation and debt.

A useful textbook will be

Ljungqvist, L. and T.J. Sargent (2004), Recursive Macroeconomic Theory, 2nd edition MIT Press.

Course Outline

1. INTRODUCING FISCAL POLICY IN DSGE MODELS

Distortionary taxes in equilibrium models, with and without capital accumulation. Capital and labor taxes, efficiency issues, redistributive issues, tax competition. Automatic stabilizers. Tax policy in a European Union.

2. EMPIRICAL ASPECTS: MEASURES OF TAX RATES, FISCAL MULTIPLIERS

Calculation of effective marginal tax rates, empirical measures. Calibration of tax policy reforms through the lens of DSGE models. Effects of fiscal policy contractions on output, fiscal multipliers.

3. FISCAL/MONETARY INTERACTIONS, GOVERNMENT DEBT, FISCAL SUSTAINABILITY.

Fiscal and monetary policy interactions. Friedman rule, the Phelps critique, seignorage. DSGE models of government debt, role of debt as a stabilizer. Models of fiscal policy with incomplete markets. Measures of fiscal sustainability.

4. EMPIRICAL ASPECTS: EFFECTS OF DEFICIT AND DEBT, INFLATION

Empirical effects of high government debt or high deficit. Interaction with inflation as a stabilizer.

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.

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Evaluation

Materials

1. INTRODUCING FISCAL POLICY IN DSGE MODELS

Lucas, R. E., JR., and N. L. Stokey (1983): "Optimal Fiscal and Monetary Policy in an Economy Without Capital" *Journal of Monetary Economics*, 12, 55-93.

Chamley, C. (1986); "Optimal Taxation of Capital Income in General Equilibrium with Infinite Lives", *Econometrica* 54.

Juan Carlos Conesa, Sagiri Kitao, Dirk Krueger, (2009). "Taxing Capital? Not a Bad Idea after All!", *American Economic Review*, vol. 99(1), pages 25-48, March.

David Domeij & Jonathan Heathcote, 2004. "On The Distributional Effects Of Reducing Capital Taxes," *International Economic Review*, vol. 45(2), pages 523-554.

Garcia-Milà, T., A. Marcet and E. Ventura (2010): "Supply Side Interventions and Redistribution", *Economic Journal*.

2. EMPIRICAL ASPECTS: MEASURES OF TAX RATES, FISCAL MULTIPLIERS

Joines, Douglass H. "Estimates of Effective Marginal Tax Rates on Factor Incomes". *Journal of Business*, vol.54, no.2, pp 191-226, 1981.

Mendoza, Enrique G. & Razin, Assaf & Tesar, Linda L., 1994. "Effective tax rates in macroeconomics: Cross-country estimates of tax rates on factor incomes and consumption," *Journal of Monetary*

Economics, Elsevier, vol. 34(3), pages 297-323, December

Alesina, Alberto F. and Silvia Ardagna (2010)..Large Changes in Fiscal Policy: Taxes Versus Spending,. *NBER Chapters in Tax Policy and the Economy*, volume 24.

Blanchard, Olivier and Roberto 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), pages 1329-1368.

3. FISCAL/MONETARY INTERACTIONS, GOVERNMENT DEBT, FISCAL SUSTAINABILITY.

Aiyagari, R, Marcet, A., T.J. Sargent and J. Seppälä (2002); "Optimal Taxation without State-Contingent Debt", *Journal of Political Economy*, December.

Chari, V.V, Christiano, L.J and Kehoe, P.J (1996) "Optimality of the Friedman rule in economies with distorting taxes", *Journal of Monetary Economics* 37, 203-223

Marcet A. and J.P. Nicolini (2003) "Recurrent Hyperinflations and Learning", *American Economic Review*, December.

Marcet. A. and A. Scott (2009); "Debt and Deficit Fluctuations and the Structure of Bond Markets", *Journal of Economic Theory*.

12M013

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Sargent T.J. and N. Wallace (1981) "Some Unpleasant Monetarist Arithmetic" Federal Reserve Bank of Minneapolis Quarterly Review, Fall.

T.J. Sargent "The Ends of Four Big Inflations," (1983) in: Inflation: Causes and Effects, ed. by Robert E. Hall, University of Chicago Press, (Reprinted in REI, p. 40--109).

Sargent, T.J. and N. Wallace (1987). "Inflation and the Government Budget Constraint", in: A. Razin and E. Sadka, eds., Economics in theory and practice, McMillan, New York.

Schmidt-Grohe, S. and M. Uribe (2004) "Optimal Fiscal and Monetary Policy under Sticky Prices", Journal of Economic Theory.

4. EMPIRICAL ASPECTS: EFFECTS OF DEFICIT AND DEBT, INFLATION

E. Ilzetzi, C. Végh (2008) "Procyclical Fiscal Policy in Developing countries: Truth or Fiction?", working paper.

C. Reinhart , K. Rogoff (2009) This Time is Different, Princeton University Press

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