

HOW BIG (SMALL?) ARE FISCAL MULTIPLIERS

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Presentation for "No Way Out" Conference Series
American Enterprise Institute

October 9, 2009

THE MULTIPLIER DEBATE

- ▶ Question: What is the impact on GDP of a \$1 increase in government expenditure (or decrease in tax revenues)?:

$$(Impact) \text{ Multiplier} = \frac{\Delta GDP_t}{\Delta G_t}$$

$$Cumulative \text{ Multiplier} = \frac{\sum_{s=0}^{\infty} GDP_{t+s}}{\sum_{s=0}^{\infty} G_{t+s}}$$

- ▶ Robert Barro (WSJ, 1/22/09): 0
- ▶ Romer and Bernstein (2009): 1.6.

CURRENT ESTIMATES

- ▶ Estimates of government expenditure multiplier:
 - ▶ Blanchard and Perotti (2002): ~ 1
 - ▶ Perotti (2004): -2.3 to 3.7 (depending on country and time period).
 - ▶ Uhlig and Mountford (2005): 0.3
 - ▶ Elmendorf and Furman (2008): 1.0
 - ▶ Ramey (2008): ~ 1
 - ▶ IMF (2008): 0.2
 - ▶ Barro and Redlick (2009): 0.6
- ▶ Limitations
 - ▶ Evidence from a small number of countries.
 - ▶ Little cross-sectional evidence.
 - ▶ almost none outside OECD.
 - ▶ Little attention to composition of G.

DATA (1)

- ▶ 25 countries: 19 high-income, 26 developing
- ▶ Real GDP, Real central government consumption
- ▶ Quarterly frequency (unbalanced panel) ranging from 1960Q1 to 2007Q4; typical country in sample 1999Q1 to 2007Q4.

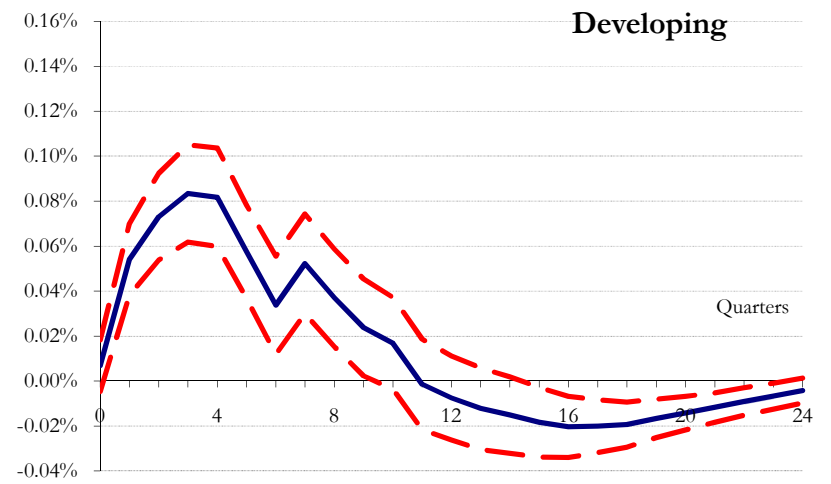
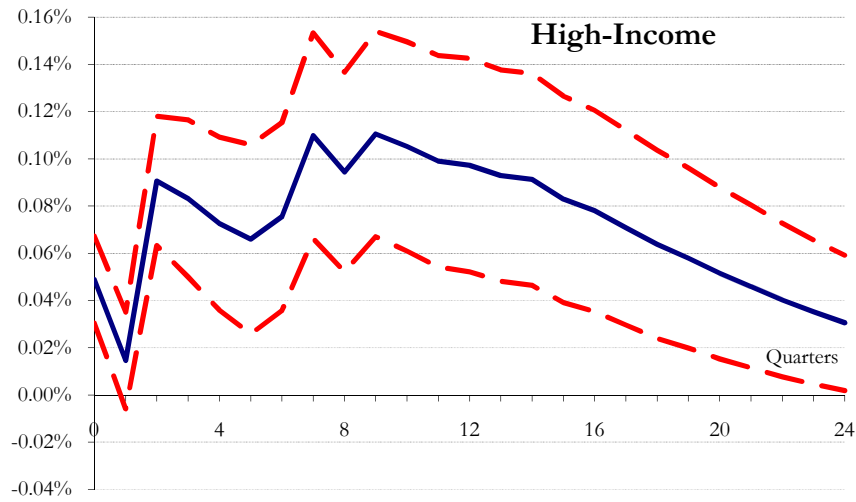
DATA (2)

- ▶ Sources: IMF, Eurostat, Central Banks, Ministries of Finance, Statistical Agencies

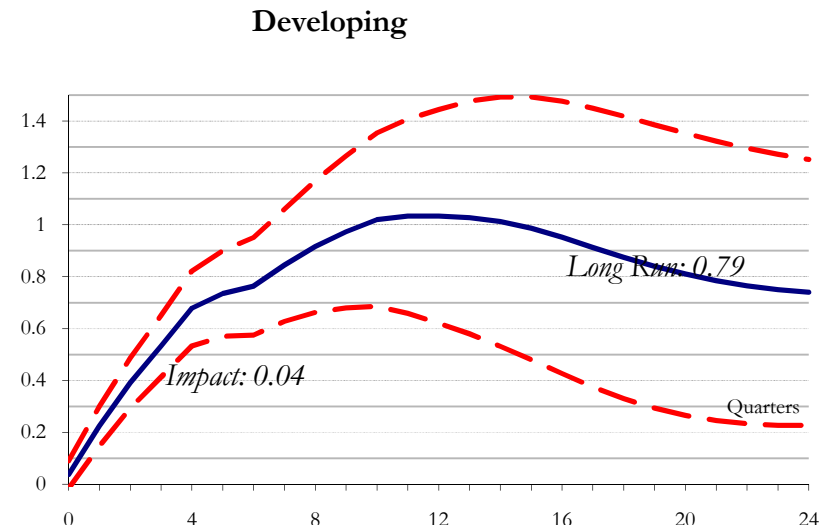
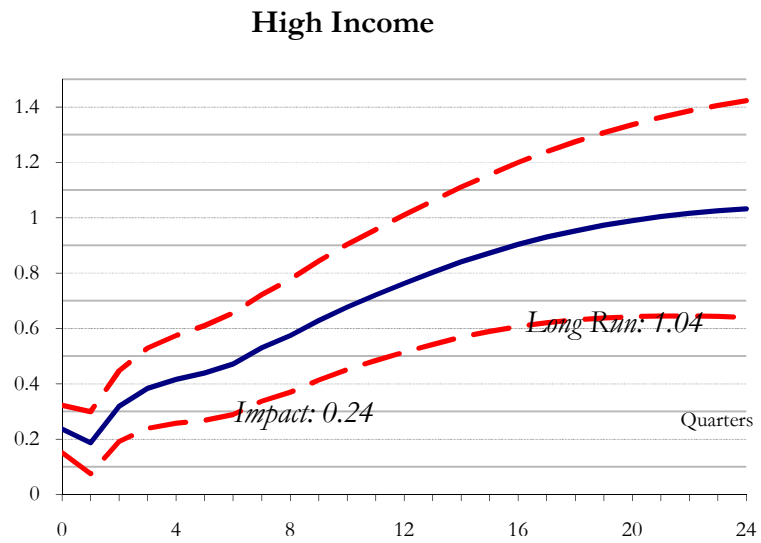
- ▶ Data carefully vetted to ensure quality and that data was collected at quarterly frequency.

- ▶ Sub-samples:
 - ▶ High-income / Developing
 - ▶ Fixed / Flex exchange rates
 - ▶ Open ($(X+M)/GDP > 60\%$) / closed
 - ▶ Developing: High ($\text{debt}/GDP > 50\%$) / low debt

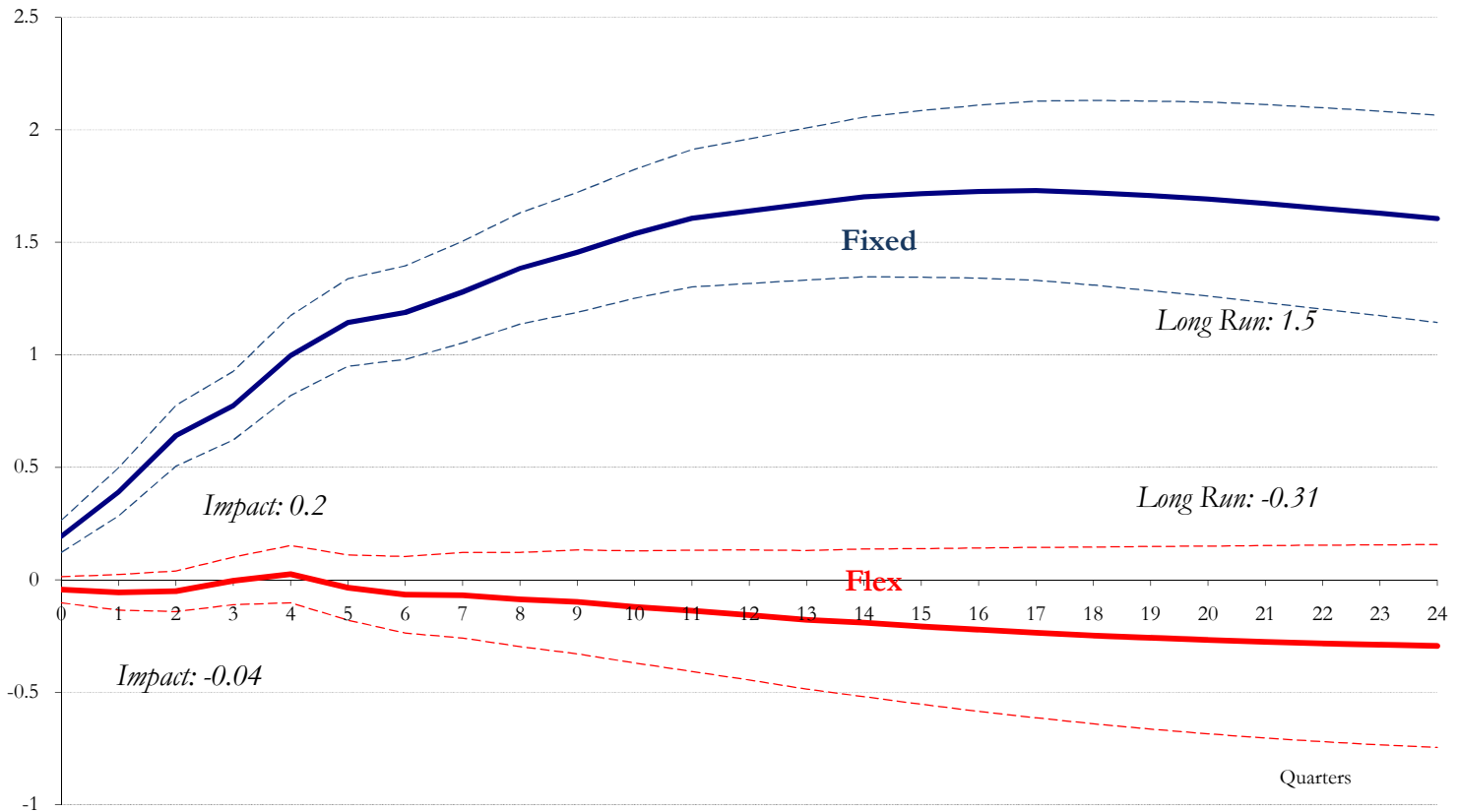
1. OUTPUT RESPONSE TO 1% SHOCK IN G



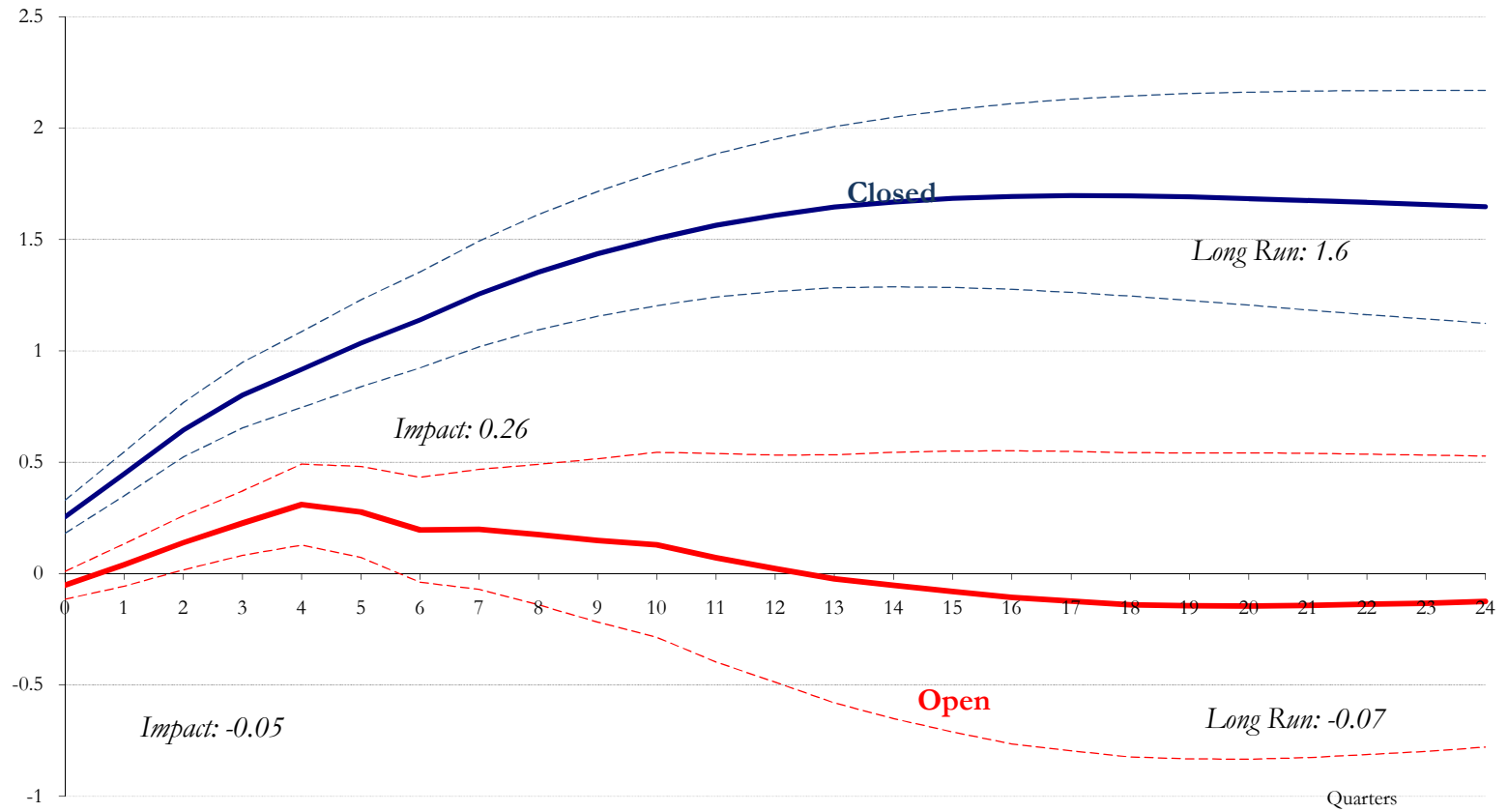
2. FISCAL MULTIPLIER



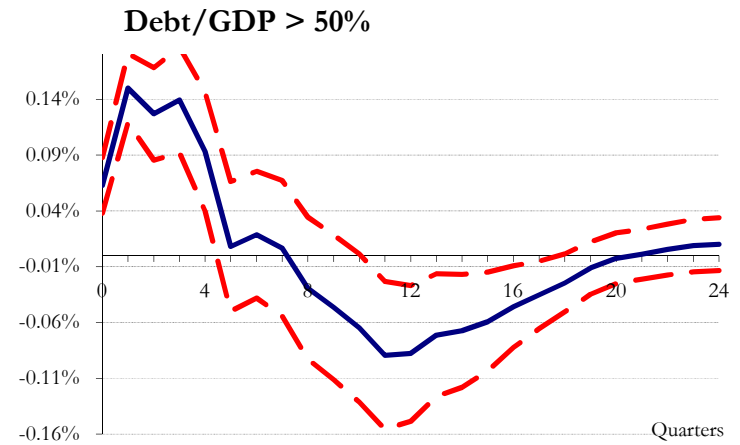
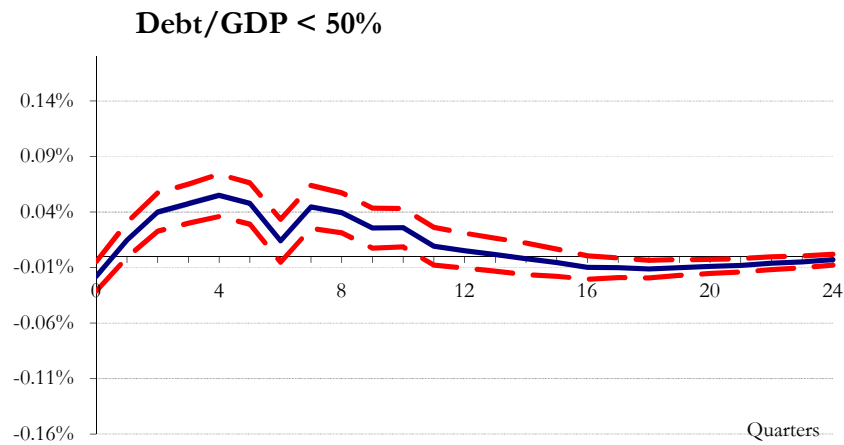
3. MULTIPLIER: FIXED VS. FLEXIBLE EXCHANGE RATES



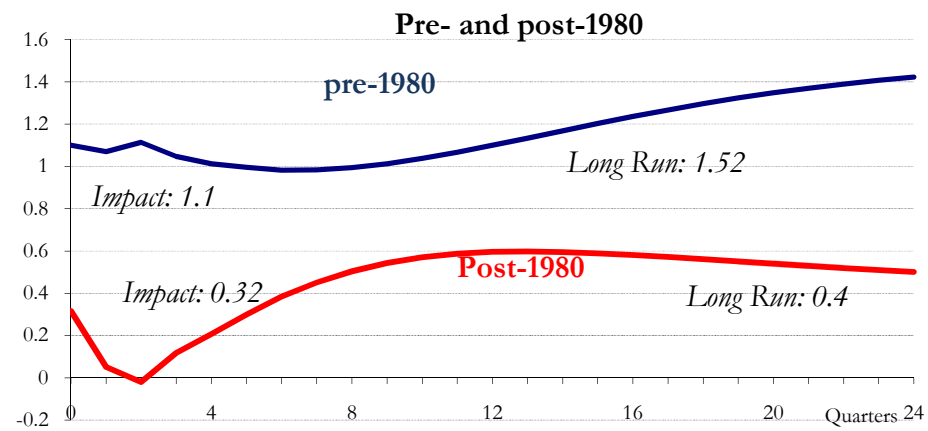
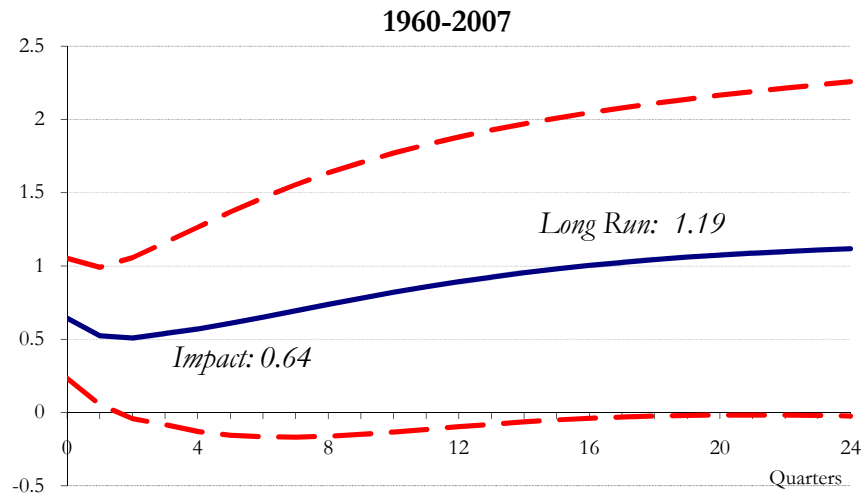
4. MULTIPLIER: OPEN VS. CLOSED ECONOMIES



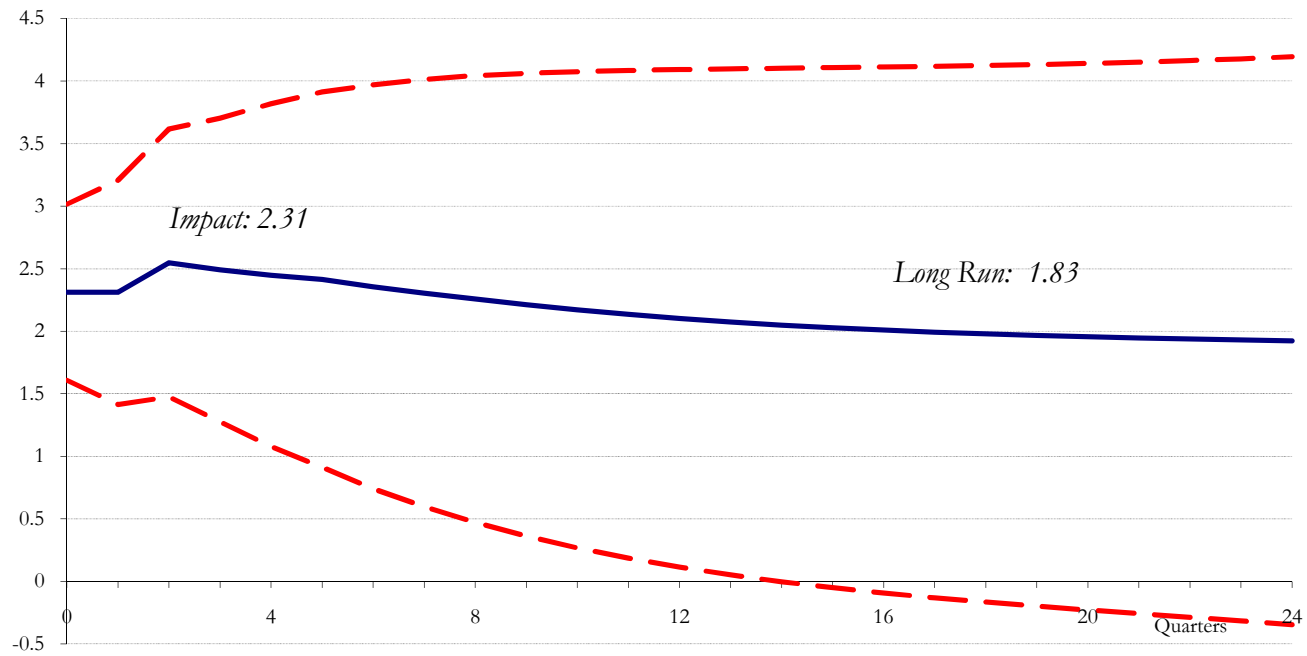
5. OUTPUT RESPONSE: FINANCIAL FRAGILITY IN DEVELOPING COUNTRIES



6. UNITED STATES



7. GOVERNMENT INVESTMENT



POLICY LESSONS: HIGH-INCOME COUNTRIES

- ▶ In a world of increasingly open borders
 - ▶ "Traditional" countercyclical fiscal policy may become less relevant or
 - ▶ might require international coordination (politically feasible?)

- ▶ Composition of stimulus package.

POLICY LESSONS: DEVELOPING COUNTRIES

- ▶ "Debt Intolerance" is important in assessing the desirability of countercyclical fiscal policies.
- ▶ As developing countries move to greater exchange rate flexibility, countercyclical fiscal policy may become less relevant.
- ▶ But insofar as "fear of floating" exists: Avoid the procyclical policies commonly observed in developing countries.