

The Future of Fiscal Policy - Discussion

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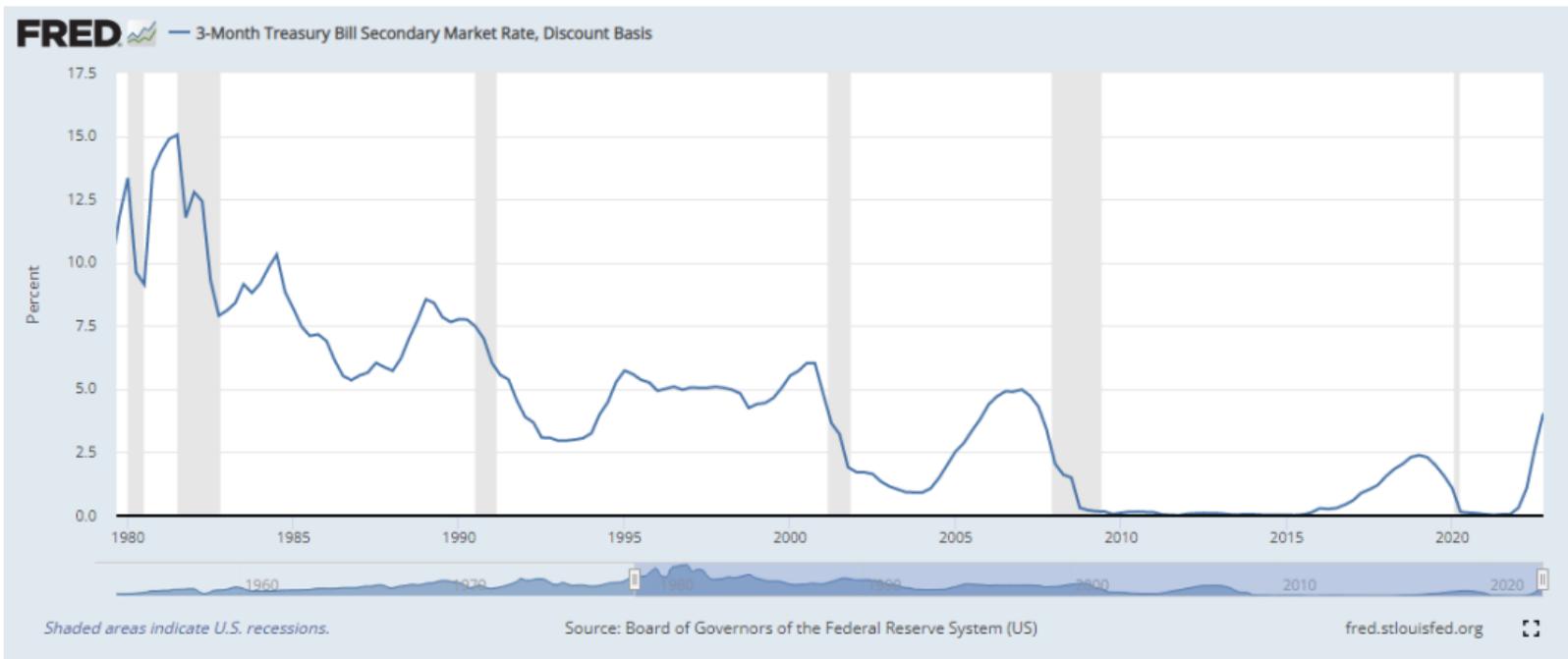
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June 9, 2023



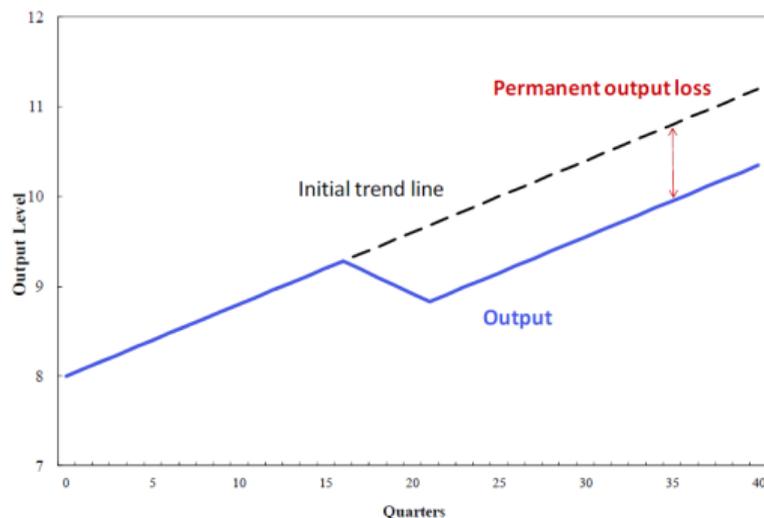
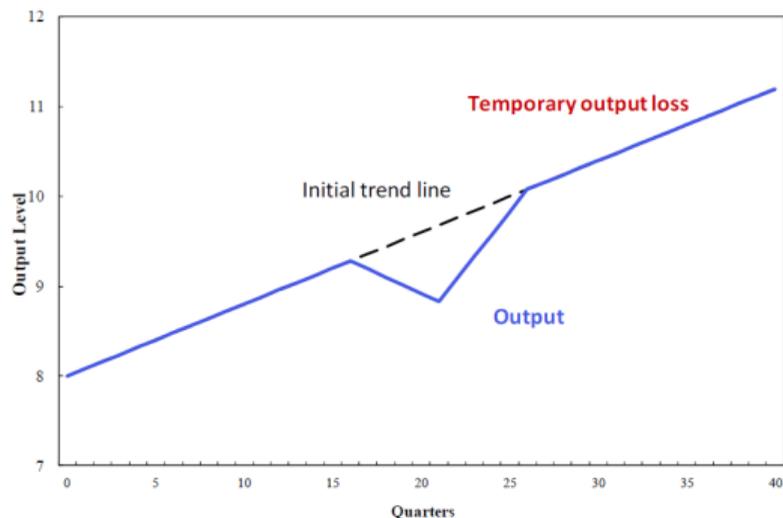
- Vitor Gaspar makes a lot of interesting and relevant points in his presentation
 - Fiscal policy is a potent tool, especially during a recession
 - But there is no free lunch
- → at some point, the budget constraint is going to bite
- Goal of this discussion:
 - provide some context, drawing from recent academic literature

Monetary policy is not enough



Source: Federal Reserve Economic Data

Recessions leave permanent scars



Source: V.Cerra & S.Saxena (2017), IMF working paper 17/250

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 - Loose fiscal policy in good times → necessary tight fiscal policy in bad times
 - Greatest output decline in recent history for middle/high-income countries
 - no real recovery yet

How do we pay off debt?

- At some point, debt has to be paid back (disregarding outright default)
- (Real) debt to GDP ratio obeys the following accounting identity:

$$d_t = \frac{1 + r_t}{\Delta y_t} d_{t-1} - s_t$$

- where d_t = debt/GDP, r_t = real rate, Δy_t = GDP growth, s_t = surplus/GDP
- Currently, fiscal stimulus somewhat pays for itself due to high GDP/inflation
 - Exceptional situation, won't last forever (see U.S now with rising interest rates)
- → At some point, surpluses have to kick in

- Two notions of future here, with different implications:
 - Near future: how do we pay off debt inherited from recessions
 - Medium/long run: how do we calibrate fiscal policy for the next recession?
- Lot to learn from current events
- Fiscal policy already informed by sluggish recovery from Great Recession
- → More reactive and better targeted to avoid unnecessary long recovery