What do structural models suggest about the magnitude of fiscal multipliers and what they depend on? What elements are the models missing?

Discussion

David Romer

An area where the models appear comparatively underdeveloped: financial-market imperfections

In many models, the key (or only) departure from perfect financial markets in the presence of hand-to-mouth consumers.

What this leaves out (I)

Households:

- Liquidity constraints
- Spreads between lending and borrowing rates
- Time-inconsistent preferences
- Rule-of-thumb behavior
- …

What this leaves out (II)

Firms:

- Credit spreads
- Credit rationing
- Agency problems and effects of cash flow
- Availability of working capital
- Firm risk aversion
- …

Why this matters (I)

Financial-market disruptions as a source of shocks

Why this matters (II)

Presence of financial-market imperfections affects impact of shocks

Example: Temporary and long-lasting tax cuts

Why this matters (III)

Financial-market imperfections can change systematically in response to shocks, providing a potentially important magnification mechanism.

The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks

Christina D. Romer
David H. Romer

Figure 6

Two-Variable VAR for Exogenous Tax Changes and Real GDP

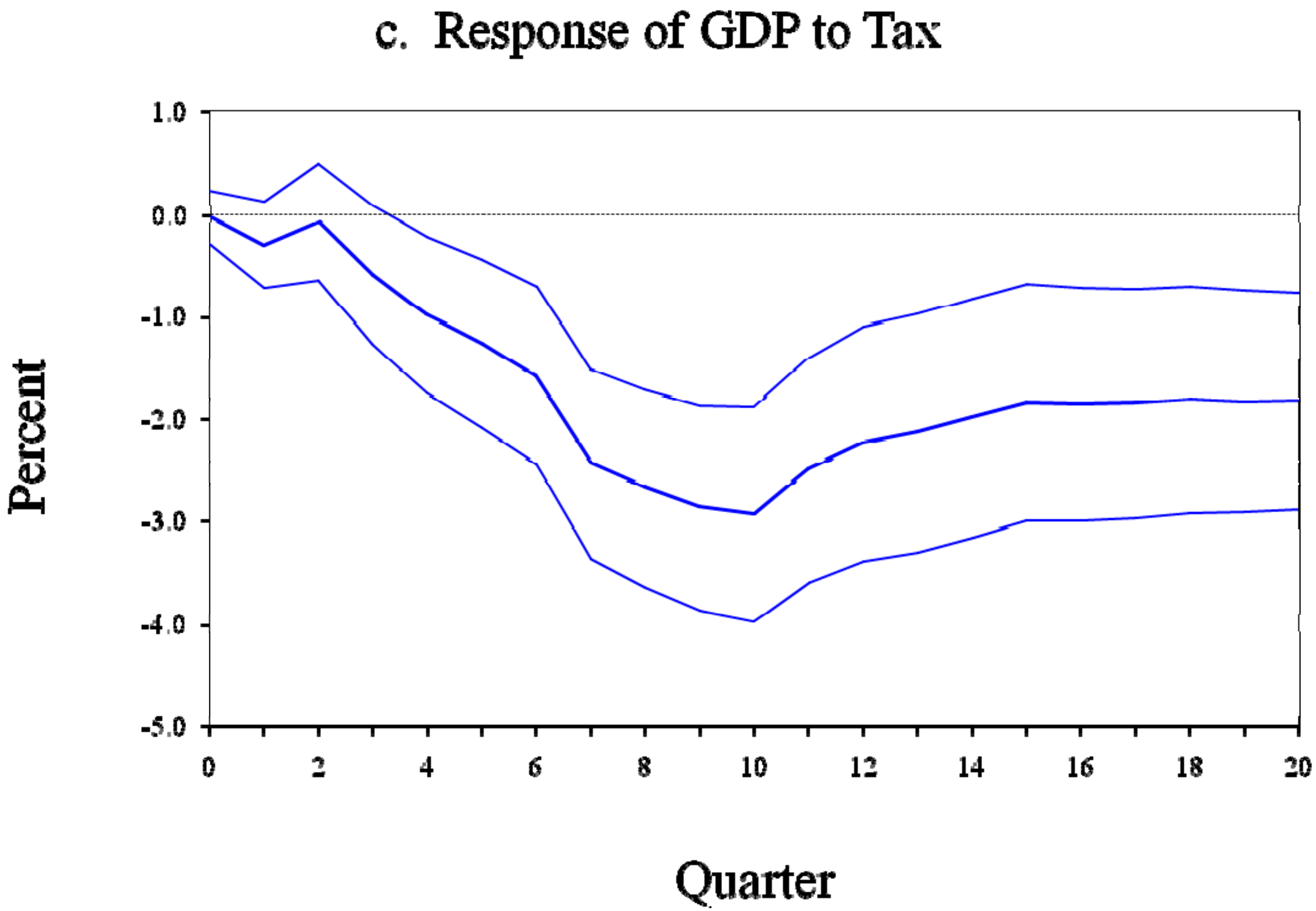

Figure 14

Estimated Impact of Exogenous Tax Increase of 1% of GDP on Components of GDP

a. GDP, Consumption, and Investment