

**The Lack of an Empirical Rationale
for a
Revival of Discretionary Fiscal Policy**

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Outline

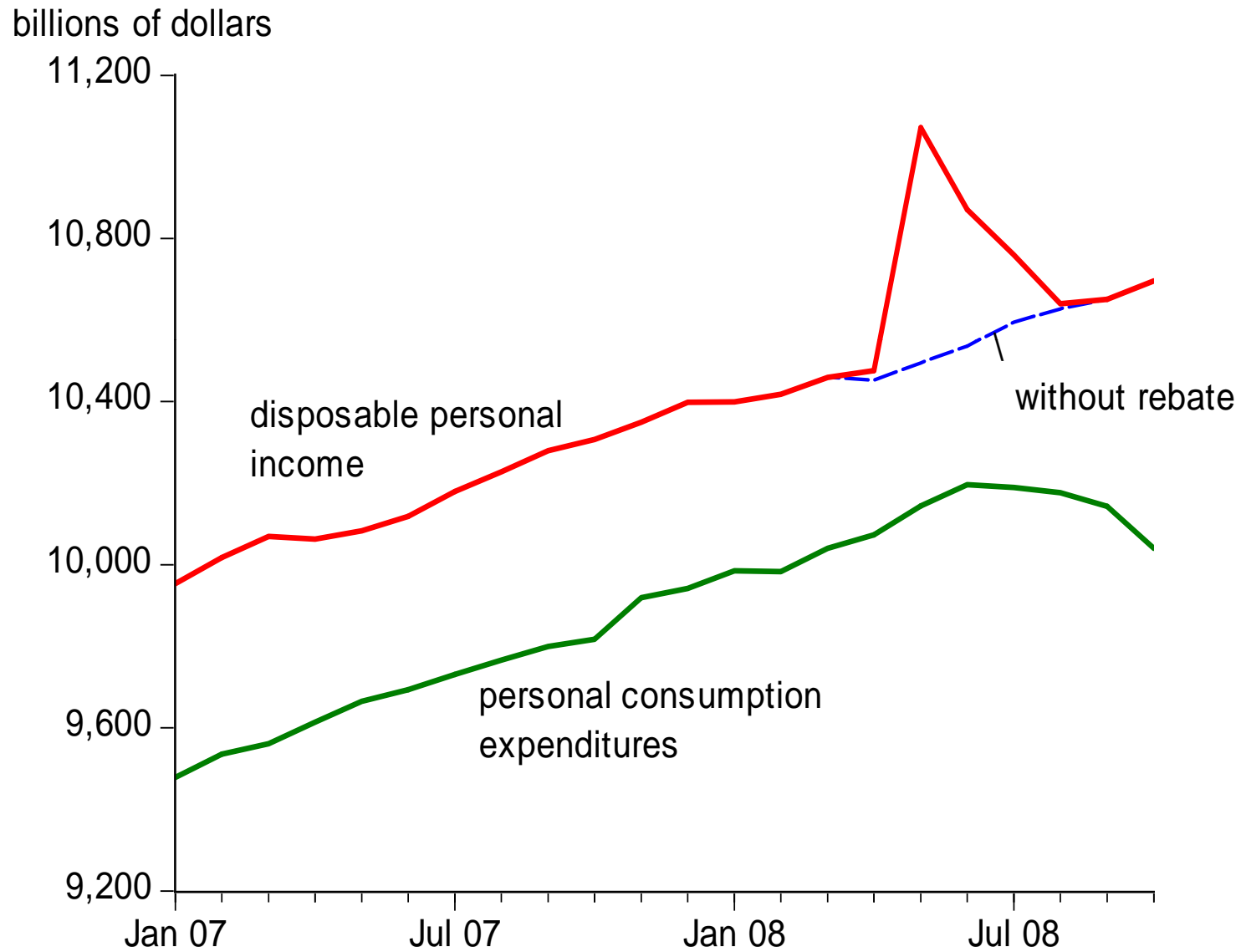
- “Widespread agreement” 10 years ago
 - “Countercyclical discretionary fiscal policy”
 - is not “desirable”
 - “has not contributed to economic stability and may have actually been destabilizing “
- Yet now a dramatic revival of interest in such policies
- Does the empirical experience over the past decade
 - Experiences with Two Temporary Tax Rebates
 - Model Simulations and Government Purchases
 - Recent Experience with the Automatic Stabilizers
 - Changes in Monetary Policy Effectivenessprovide rationale for such a revival? No.

Rebate Payments in 2001 and 2008

(billions of dollars, annual rates)

	<u>2001</u>	<u>2008</u>
April	0	23.3
May	0	577.1
June	0	334.4
July	95.1	164.1
August	223.1	12.4
September	144.9	0
October	2.5	0

No Significant Impact of Rebates on Consumption



PCE Regressions with Rebate Payments

Lagged PCE	.794 (.057)	.832 (.056)
Rebate payments	.048 (.055)	.081 (.054)
Disp. Pers. Income (w/o rebate)	.206 (.056)	.188 (.055)
Oil Price (\$/bbl lagged 3 months)	-----	-1.007 (.325)
R ²	.999	.999

Dependent variable = PCE

Oil price – West Texas Intermediate.

Sample period is January 2000 to October 2008.

Standard errors in parentheses.

Government Purchases

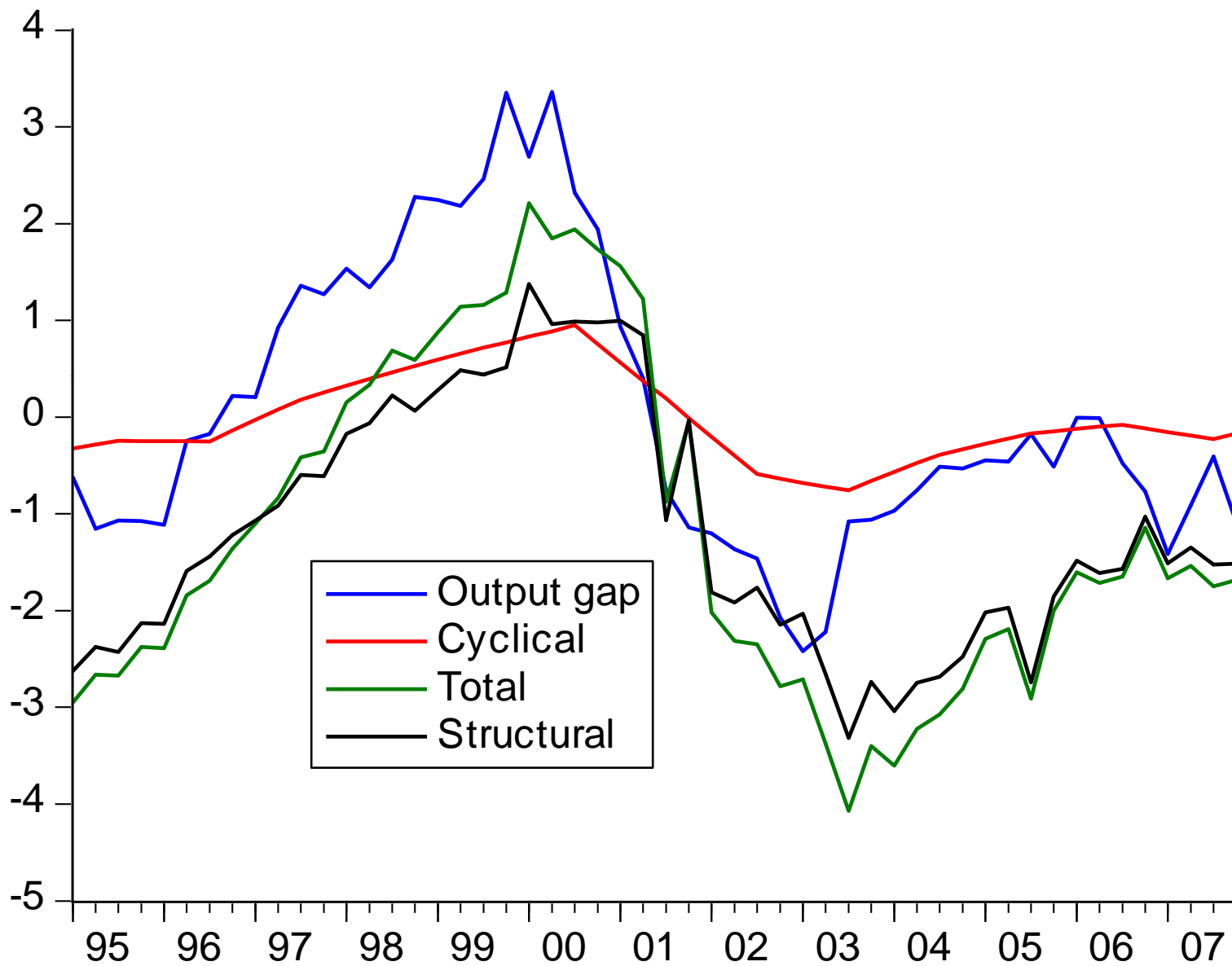
- Failure of Economic Stimulus Act of 2008 has led to proposals to increase government purchases
- Yet little evidence that this will work either as a way to end recession, sustain recovery
 - Models used are the same ones used for the rebate
 - E.g. Zandi (2008): Estimated bang for buck from rebate was \$1.26, but in reality not significantly different from \$0.00
- International dynamic RE models find many offsetting effects: e.g. Taylor multicountry model
- History as a guide: 1950s?
- International comparisons as a guide: Japan?

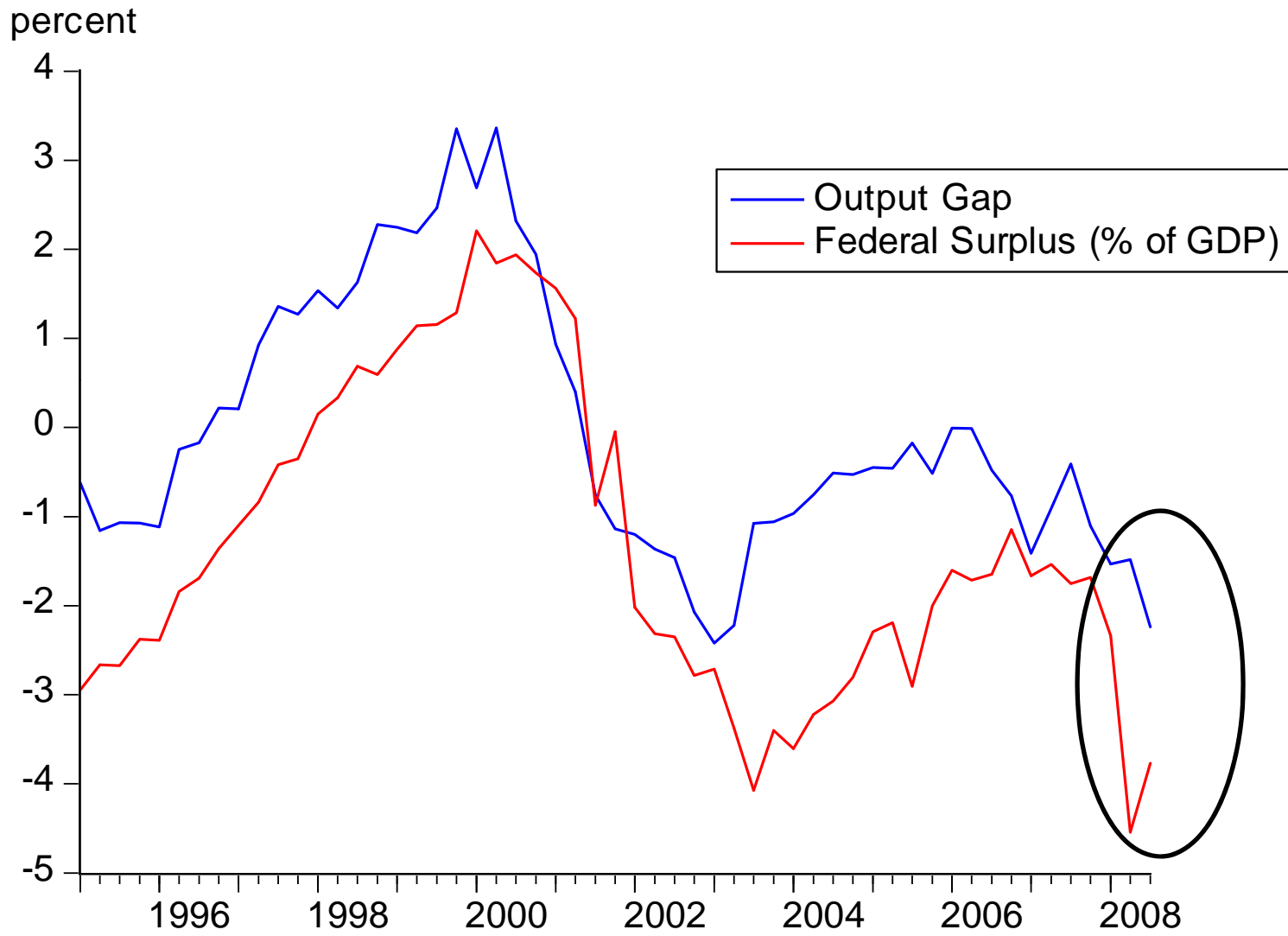
Large Role of Automatic Stabilizers

Simple Regression Coefficients of Deficit as a Percent of GDP on the percentage GDP Gap

<u>Sample</u>	<u>Structural</u>	<u>Cyclical</u>	<u>Total</u>
1983:1 1994:4	.00	.35	.36
1983:1 1997:4	.14	.35	.49
1983:1 2007.4	.48	.34	.82
1995:1 2007:4	.71	.29	1.00

Percent

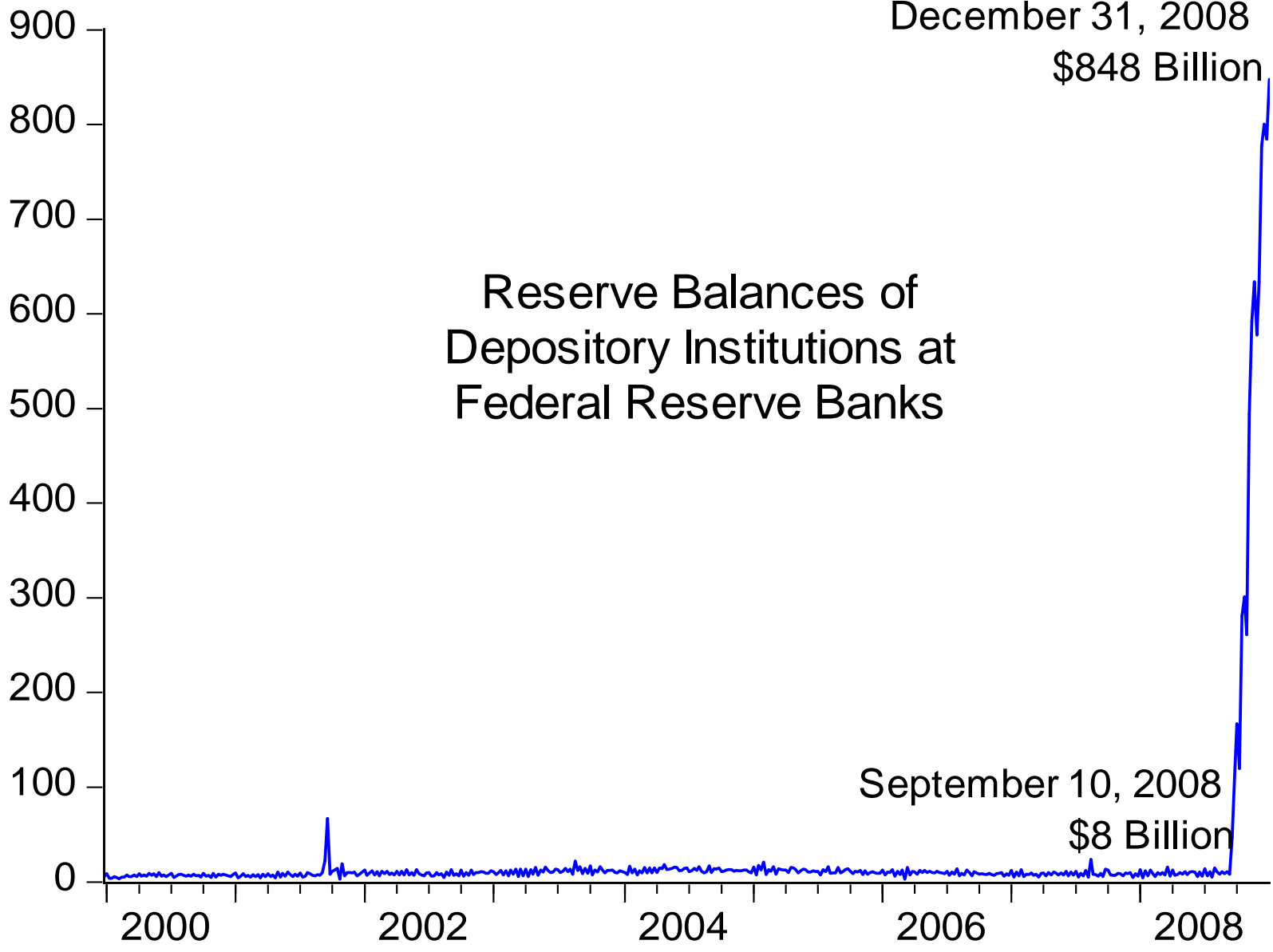




Changes in Monetary Policy Effectiveness

- Zero bound on interest rates
- Quantitative easing appears to have begun in U.S. on September 17 when monetary base began to explode (see chart) due to new Fed facilities
- Empirical experience of the past decade?
 - Once Japan moved to quantitative easing in 2001 it began to move out of the lost decade
 - Again no new empirical rationale for a revival of fiscal policy

billions of dollars



Reserve Balances of Depository Institutions at Federal Reserve Banks

Conclusion

Review of empirical experience over the past decade

- Experiences with Two Temporary Tax Rebates
- Model Simulations and Government Purchases
- Recent Experience with the Automatic Stabilizers
- Changes in Monetary Policy Effectiveness

Provides no empirical rationale for a revival of countercyclical discretionary fiscal policy