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 Effectiveness

provide rationale for such a revival? No.
# Rebate Payments in 2001 and 2008
(billions of dollars, annual rates)

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>April</td>
<td>0</td>
<td>23.3</td>
</tr>
<tr>
<td>May</td>
<td>0</td>
<td>577.1</td>
</tr>
<tr>
<td>June</td>
<td>0</td>
<td>334.4</td>
</tr>
<tr>
<td>July</td>
<td>95.1</td>
<td>164.1</td>
</tr>
<tr>
<td>August</td>
<td>223.1</td>
<td>12.4</td>
</tr>
<tr>
<td>September</td>
<td>144.9</td>
<td>0</td>
</tr>
<tr>
<td>October</td>
<td>2.5</td>
<td>0</td>
</tr>
</tbody>
</table>
No Significant Impact of Rebates on Consumption

- **Disposable Personal Income**: Shows a steady increase with a significant spike in Jan 08.
- **Personal Consumption Expenditures**: Shows a gradual increase with a peak in Jul 07 and a slight dip in Jul 08.
- **Without Rebate**: Indicates a consistent trend without the spike seen in the rebate scenario.
## PCE Regressions with Rebate Payments

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard Error</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lagged PCE</td>
<td>0.794</td>
<td>0.057</td>
</tr>
<tr>
<td></td>
<td>0.832</td>
<td>0.056</td>
</tr>
<tr>
<td>Rebate payments</td>
<td>0.048</td>
<td>0.055</td>
</tr>
<tr>
<td></td>
<td>0.081</td>
<td>0.054</td>
</tr>
<tr>
<td>Disp. Pers. Income (w/o rebate)</td>
<td>0.206</td>
<td>0.056</td>
</tr>
<tr>
<td></td>
<td>0.188</td>
<td>0.055</td>
</tr>
<tr>
<td>Oil Price ($/bbl lagged 3 months)</td>
<td>------</td>
<td>-1.007</td>
</tr>
<tr>
<td>R²</td>
<td>0.999</td>
<td>0.999</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Sample</th>
<th>Structural</th>
<th>Cyclical</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1983:1 1994:4</td>
<td>.00</td>
<td>.35</td>
<td>.36</td>
</tr>
<tr>
<td>1983:1 2007:4</td>
<td>.48</td>
<td>.34</td>
<td>.82</td>
</tr>
<tr>
<td>1995:1 2007:4</td>
<td>.71</td>
<td>.29</td>
<td>1.00</td>
</tr>
</tbody>
</table>
Output Gap
Federal Surplus (% of GDP)
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
Reserve Balances of Depository Institutions at Federal Reserve Banks

- December 31, 2008
  - $848 Billion
- September 10, 2008
  - $8 Billion
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