

Comments on Gauti Eggertsson
“A Tale of Two Countries: Fiscal Multipliers and Policy Coordination”

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I. Summary

II. Comments

I. Summary

- Stylized fact used to motivate the paper: despite qualitative similarities in starting points, the U.S. was more successful at pulling out of its liquidity trap of the 1930s than Japan has been in pulling out its own liquidity trap. One particularly notable difference: while the money supply grew rapidly in both countries, nominal output grew in the U.S. but not Japan.
- Eggertsson argues that the key difference between the two countries is that fiscal and monetary policy were coordinated in the U.S.. In the U.S., the fiscal authority (a.k.a. President Roosevelt) was committed to raising the price level and perceived as capable of promoting that commitment. There was no such coordination between fiscal and monetary policy in Japan.
- The paper develops a stylized model to formalize the benefits of coordination, and proposes a policy rule that is generally applicable in times of liquidity trap.

I summarize in turn the model, the U.S.-Japan comparison, and the proposed policy rule.

- The analysis uses a sticky price model that is in many ways familiar. Two features of the model that are not part of the baseline sticky price model: Government consumption appears as a separable term in the utility function, and there is a cost to raising (lump sum) taxes.
- After log-linearization, we end up with the usual intertemporal IS equation (16) and the usual Calvo price setting equation (17).
- A second order approximation of household utility delivers a function that is quadratic not only on inflation and the output gap, but government consumption and taxation as well.
- The liquidity trap is assumed to result from an exogenous fall in the natural rate of interest—specifically, an exogenous downward shift down in the IS curve, modeled as a preference shock. The economy is assumed to climb out of the liquidity trap when the exogenous component of the natural rate shifts back up. Once out of the liquidity trap, we stay out. The shift in the natural rate is the only stochastic element of the model.

- Suppose first that monetary and fiscal policy is coordinated, and that government authorities set policy to maximize household utility.
- Eggertsson shows that when we climb out of the liquidity trap, optimal policy inflates away some government debt.
- When the monetary and fiscal authorities work together, then, people recognize that those authorities have an incentive to inflate as we transit from the liquidity trap. This has healthy effects.

- Suppose, on the other hand, that the monetary and fiscal authorities do not coordinate. Let the monetary authority make decisions thinking only about the output gap and inflation, while the fiscal authority maximizes household utility.
- Then the monetary authority will have no incentive to inflate away debt, and people will recognize that the monetary authority has no such incentive: the perceived commitment to inflate in the future is less than in the coordinated equilibrium.
- While the probability of a jump in the exogenous component of the natural rate is the same whether or not there is coordination (by assumption), the depth of the recession is less under coordination.

- Some stylized calculations suggest that the quantitative effects of coordination vs. no coordination are large. In particular, fiscal multipliers are calibrated to be much larger in the U.S. of the 1930s than in Japan of recent years (Tables 1 and 2, p23).

- Additional support for the view that coordination is central to the differences between the U.S. of the 1930s and Japan of recent years comes from the U.S. experience of 1937. A perceived temporary departure from coordination, and from a commitment to raise prices, led to a slump in the U.S.. The turnaround from the slump followed a renewal of coordination and of commitment to raise prices.

- Since one wants an independent central bank during normal times, Eggertsson proposes that there be a policy of temporarily tying the hands of the monetary authority: let the monetary authority buy government debt at zero i until a prespecified price level is reached. The bank then again is granted independence.

II. Comments

- Excellent paper, combining formal model, historical analysis and policy advice.
- The idea makes sense: if the fundamental prescription for getting out of a liquidity trap is committing to inflate (per Krugman-Eggertsson-Woodford), then it helps if the public perceives the central bank as having an incentive to inflate away the value of government debt.
 - This is related to but not a simple restatement of the following: if it is good in normal times to have an independent central bank because independence leads to lower inflation, it may be bad to have an independent central bank in liquidity trap times because lack of independence may lead to higher inflation.

With respect to the Japan-U.S. comparison (rapid money growth in both countries, nominal output growth in the U.S. but not Japan):

- Since money velocity is a central motivating fact, it would seem that the paper's calibration should more or less attempt to match the velocity facts.
- In matching those or other facts, and taking as given that the explanation for the differences in nominal output growth results from policy difference of the sort discussed in the paper, is it possible to distinguish between the effects of:
(a) price level target in the U.S. vs. inflation target in Japan, and (b) coordination or lack thereof between fiscal and monetary authorities?

- More generally, in understanding cross-country differences in various variables, including the movement in nominal output during a period of rapid growth in money, to what extent is coordination important, vs. possible differences in

- troubles in the banking system
- TFP
- asset price fluctuations
- wage and price stickiness
- international influences

- Two questions about the proposed policy
- The proposal for coordination is praiseworthy, but doesn't it have the usual costs and drawbacks of commitment vs. discretion
 - lack of flexibility
 - political and operational difficulties in legislating and enforcing the commitment
- What are the benefits and costs to this proposal versus other methods, such as exchange rate targeting (Svensson), open market operations (Auerbach and Obstfeld), carry tax (Goodfriend)?

- In answering questions such as those posed above, the paper might be better off focusing either on the Japan-U.S. comparison, or on the proposal for coordination, in the end being split in two.
- Final comment: excellent paper!