

Discussion: “A Fiscal Theory of Trend Inflation”

by F. Bianchi, R. Faccini and L. Melosi

Davide Debortoli

Universitat Pompeu Fabra, CREi and BSE

- **Large Evidence on “Trend” Inflation**

[see e.g. Stock and Watson (2007), Cogley and Sargent (2015)]

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- **This paper:**
 - **Idea:** change in the behavior of central banks **caused by fiscal policy**
 - **Novel framework:** coexistence of two monetary-fiscal regimes, depending on type of shock.
 - **Main result:** estimated “unfunded” fiscal shocks account for large share of inflation

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The Model

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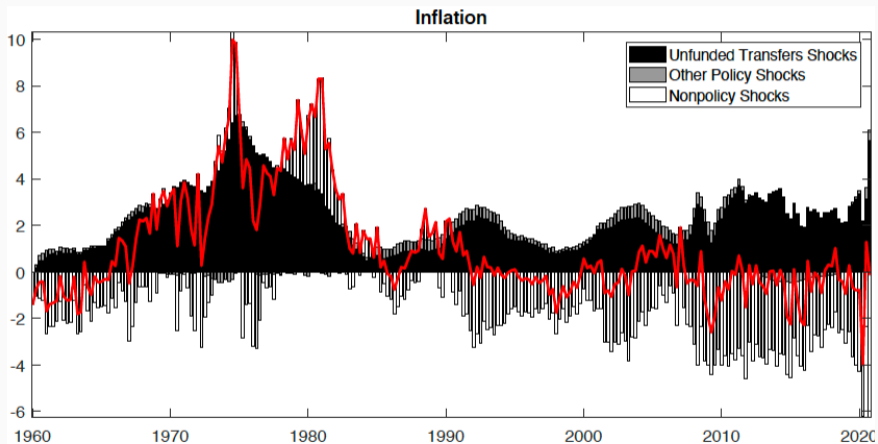
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- **Monetary rule:** only responds to inflation unrelated to unfunded shocks ($\pi_t - \pi_t^F$)
- b_{t-1}^F and π_t^F are debt and inflation due to (current and past) “unfunded” shocks $\{\epsilon_{t-j}^F\}_{j=0}^t$
 - determined in a separate “regime”

Inspecting the Mechanism

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- **Main mechanism:** $\epsilon_t^F \uparrow \Rightarrow \pi_t^F \uparrow \Rightarrow r_t \downarrow \Rightarrow \pi_t \uparrow$
 - π_t^F is a time-varying inflation target
 - ... a monetary “shock” that depends on (current and past) fiscal shocks

The Main Result



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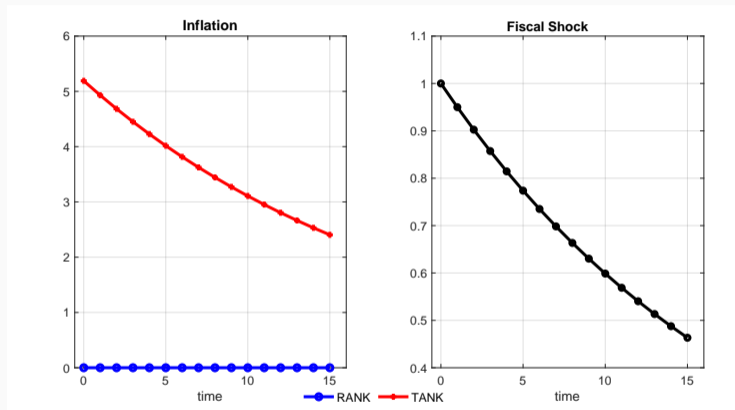
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- **A simple example:** Two-Agent New Keynesian model (TANK)
 - **Fiscal policy** (“passive”): balanced budget, transfers to “Hand-to-Mouth” households

$$\tau_t = \rho_\tau \tau_{t-1} + \zeta_t$$

- **Monetary policy** (“active”): follows standard Taylor rule

Effects of Funded Redistribution in TANK



- **Mechanism:** redistribution towards “Hand-to-Mouth” Households \Rightarrow Demand stimulus \Rightarrow Higher Inflation

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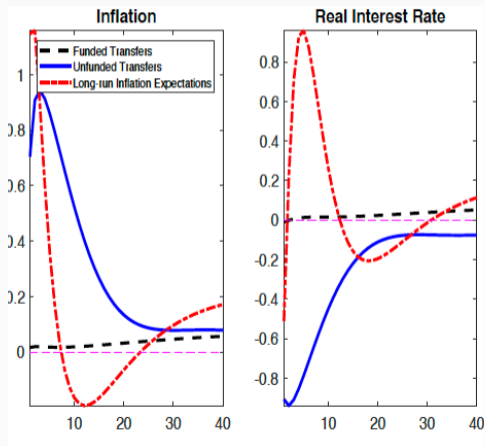
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 - negative shocks, leading to monetary expansions and automatic stabilizers
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 - negative shocks, leading to monetary expansions and automatic stabilizers
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 2. What about “reverse” causality?
 - expansionary monetary shock \Rightarrow lower cost of debt \Rightarrow higher fiscal spending

Comment #3: Identification of “Unfunded” Transfers

- In this model, “unfunded transfer” shocks looks like standard monetary shocks: $\pi \uparrow, r \downarrow$
- **Question:** How can they be distinguished from “pure” monetary shocks?



Other Comments / Suggestions

- In the estimation, no fiscal reaction to “unfunded” transfers shocks ($\gamma^F = 0$)
 - estimating that parameter uncovers how “active” is fiscal policy?
- “weak identification” of persistence parameters of transfers vs inflation shocks
 - prior and posterior almost coincide
- comparison with other (nested?) models
 - fiscal shocks play important role, which shocks become less important?
 - does the model fit the data better?
- discuss more implications for volatility of inflation and other variables [e.g. Ascari and Sbordone (2014)]

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 - novel framework to study “shock-dependent” fiscal-monetary policies
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- **Open questions:** to explain trend inflation....
 - alternative fiscal mechanisms (other than the FTPL)?
 - other factors behind changes in fiscal and monetary “rules”?