
Discussion of
The Design of Monetary and Fiscal
Policy: A Global Perspective

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Main Points

- Determinacy is a desirable property of monetary policy
 - Determinacy may be a big problem in New Keynesian models with bonds or capital
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Background

- Basic New Keynesian model without capital
 - $\pi_t = \lambda y_t + \beta E_t \pi_{t+1}$
 - $y_t = -\sigma(i_t - E_t \pi_{t+1}) + E_t y_{t+1}$
 - Equilibrium is determinant so long as the interest rate follows the Taylor principle
 - $di/d\pi > 1$
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Background

- Benhabib, Schmidt-Grohe and Uribe:
 - money in the production function
 - marginal cost increasing with the interest rate (cost channel)
 - $\pi_t = \lambda(\delta i_t + y_t) + \beta E_t \pi_{t+1}$



Background

- Dupor introduces capital
 - Argues
 - Indeterminacy and non-existence likely
 - Taylor principle bad
 - Better if $di/d\pi < 1$
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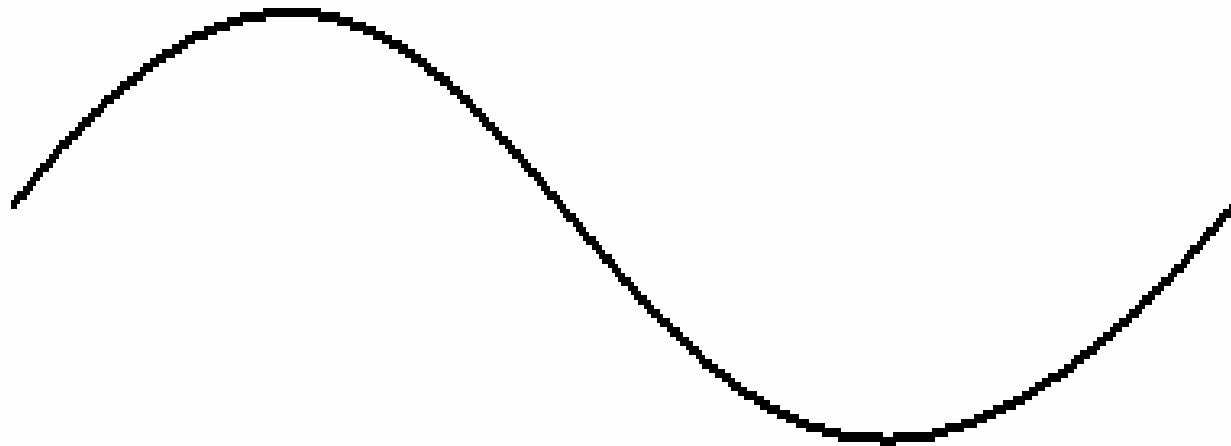
Background

- Carlstrom and Fuerst
 - Dupor's results depend crucially on his continuous time framework
 - investment depends on *current* marginal product of capital
 - With discrete time:
 - Determinacy a problem if lots of price stickiness.
 - Taylor principle leads to stability and determinacy for reasonable parameterizations.
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Story

- Complex
 - Suppose expected inflation rises.
 - Real interest rate rises (Taylor principle)
 - Marginal cost falls today, but is placed on an upward trajectory.
 - Destabilizing today
 - Stabilizing tomorrow
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Story



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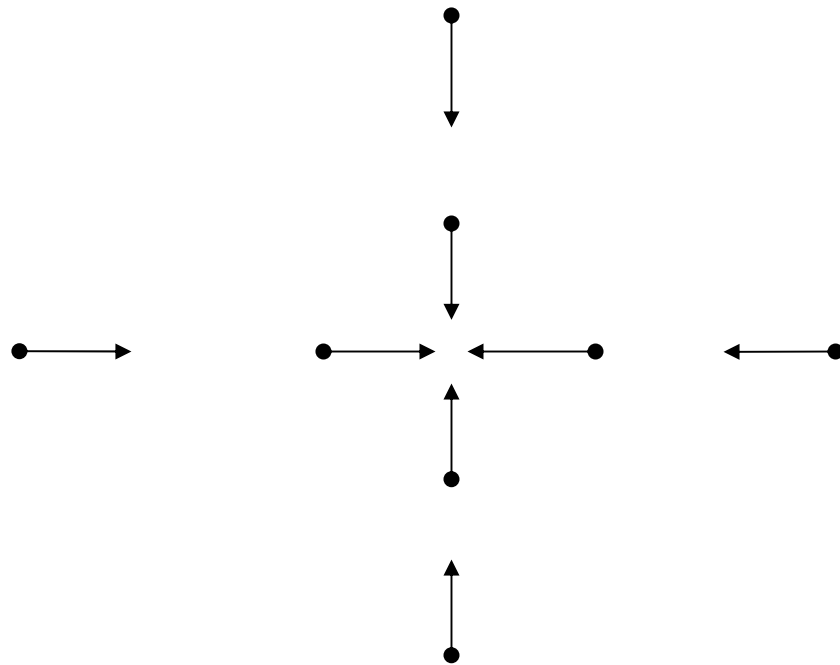
Background

- Sveen and Weinke argue that Carlstrom and Fuerst too optimistic.
 - Kimball shows that anything that makes a firm's marginal cost more sensitive to its own output increases price stickiness.
 - Carlstrom and Fuerst assume a single economy wide market for capital.
 - If assume that capital is firm specific, price stickiness increases.
 - an economy with prices fixed for 4 quarters looks like an economy with prices fixed for 10 quarters.
 - Equilibrium is no longer determinant for "reasonable" parameters.
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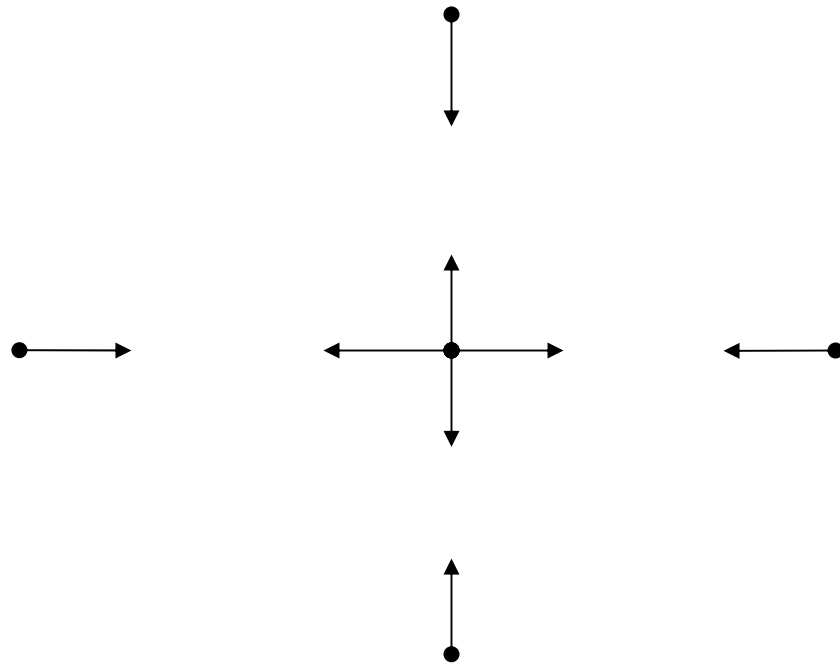
This Paper

- Considers global conditions for determinacy.
 - Argues that Sveen and Weinke too optimistic.
 - There exists a neighborhood of the border between the regions of determinacy and indeterminacy in which the local conditions for determinacy are satisfied, and yet there still exist lots of other equilibria.
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This Paper



This Paper



What do we do now?

- Don't Panic
 - Think more about equilibrium selection
 - Learning
 - Complexity
 - Nature of the game
 - Think more about non-linearities
 - Here the Fed policy is log-linear, while analysis is non-linear.
 - Think more about “reasonable” parameter values.
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