

How Much Should We Rely on Fiscal Stimulus?

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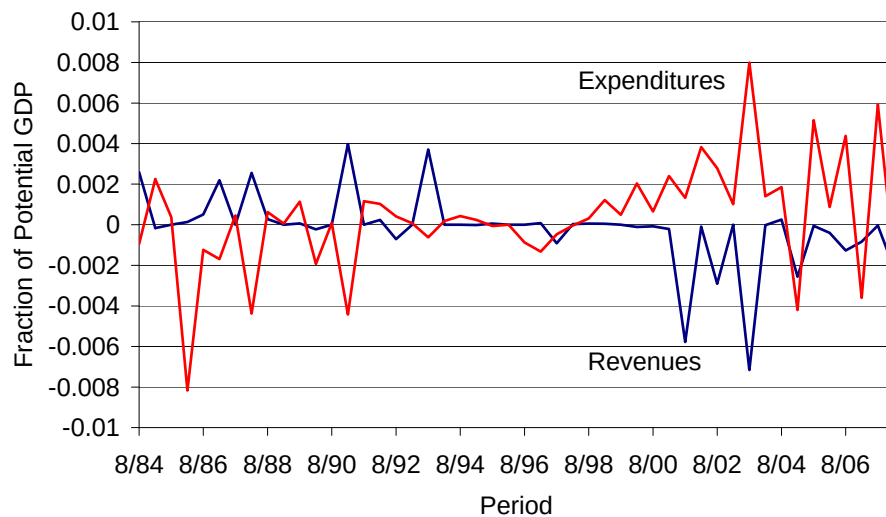
Overview

- Historical perspective: how active has fiscal policy been?
- Related questions:
 - can policy actions be anticipated?
 - what are the implications?
- Is discretionary policy helpful at stabilization?
- What about automatic stabilizers?

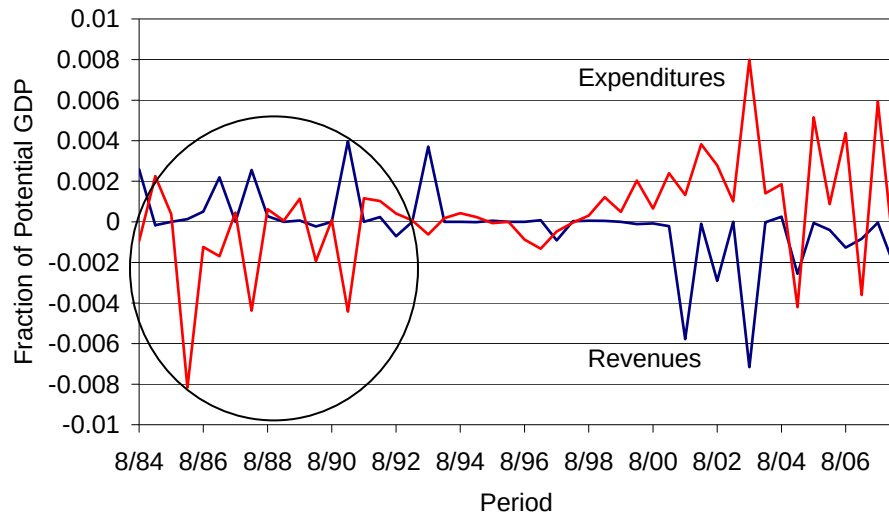
How Active Has Policy Been?

- What is a policy *change*?
- Define policy changes as measured by CBO: policy-related changes in revenues and non-interest expenditures between forecasts
 - Use weighted sum of current and future fiscal years' policy changes, as estimated by CBO
 - Semi-annual frequency since 1984
 - Scaled by potential GDP

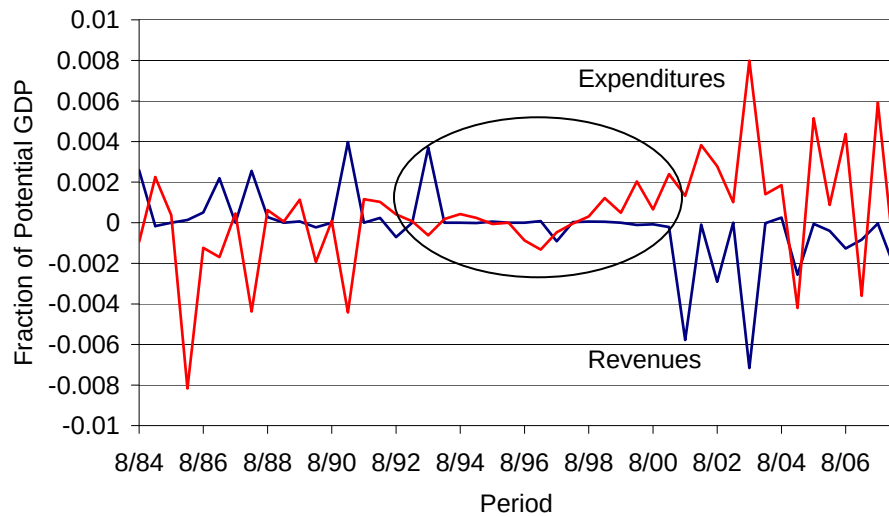
Changes in Revenues and Spending



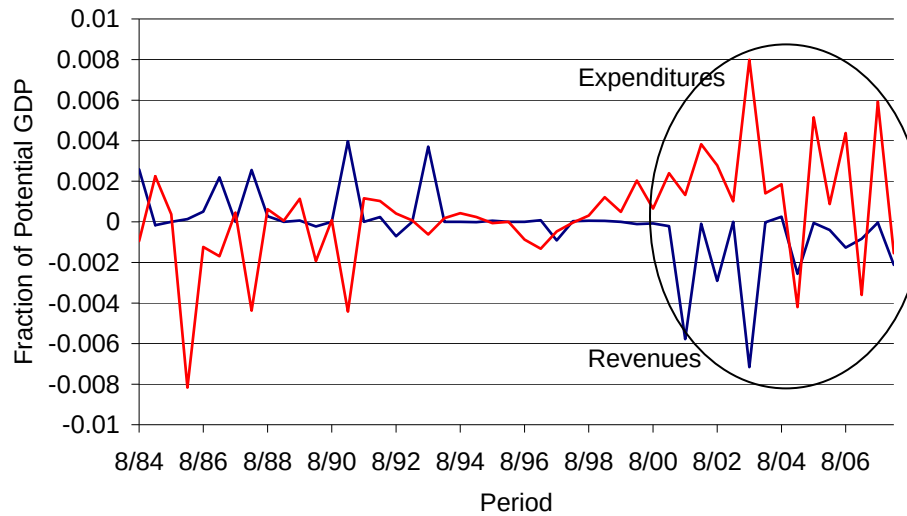
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Policy Reaction Functions

(t-statistics in parentheses)

Dependent Variable: Sample Period:	Revenue Changes			Spending Changes		
	Full Sample	Clinton	GWB	Full Sample	Clinton	GWB
Intercept	-0.001 (3.959)	-0.001 (1.191)	-0.002 (2.628)	0.002 (4.008)	0.001 (3.117)	0.002 (1.408)
Output Gap (-1)	-0.074 (3.273)	-0.068 (1.348)	-0.067 (0.851)	0.117 (3.464)	0.060 (1.729)	0.197 (1.648)
Projected Surpluses (-1)	-0.075 (4.628)	-0.069 (1.753)	-0.082 (1.805)	0.111 (4.595)	0.079 (2.925)	0.116 (1.708)
$\bar{R}^2$	.294	.152	.103	.289	.606	.096
Observations	48	16	14	48	16	14

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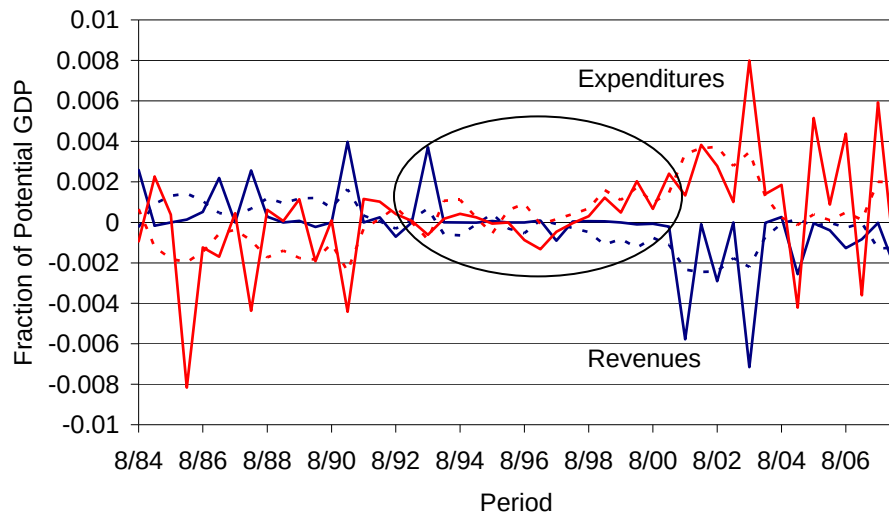
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Changes in Revenues and Spending



Investment Incentives

- A quiet period from 1987-2001
- Since then, bonus depreciation
 - introduced (at 30%) in 2002
 - expanded (to 50%) in 2003
 - expired at the end of 2004
 - reintroduced in 2008 (for 2008 only) as part of stimulus package

Investment Incentives

- Note that virtually all changes in incentives have been tied to investment, rather than to income (e.g., via tax rates)
- These two approaches have very different announcement effects
 - Expected investment incentives *discourage* investment
- How predictable have the changes been?
 - Consider annual data since 1962

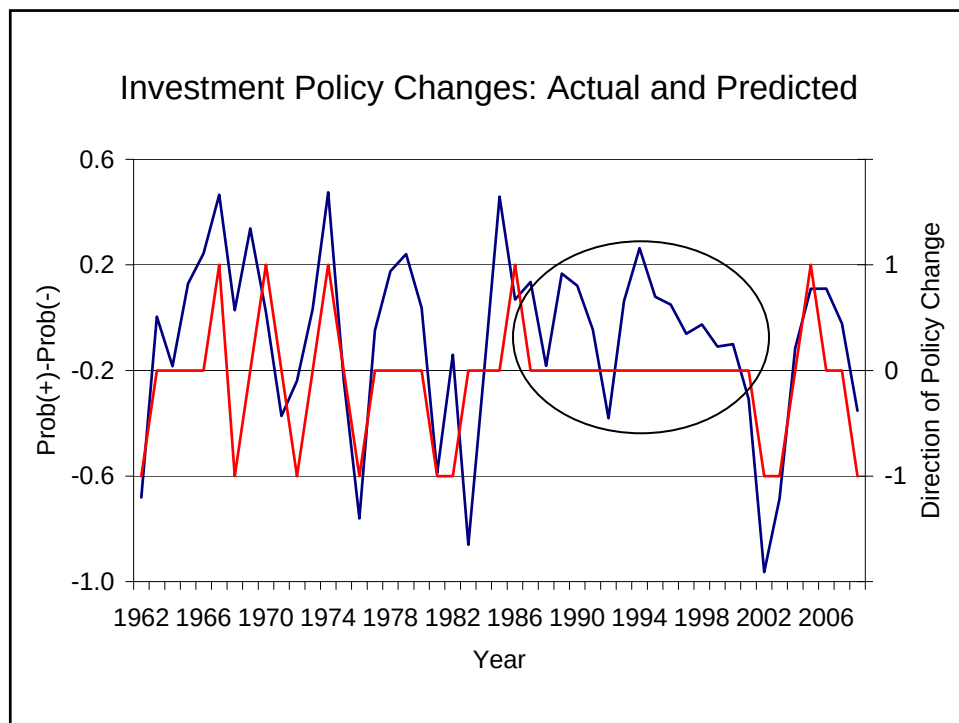
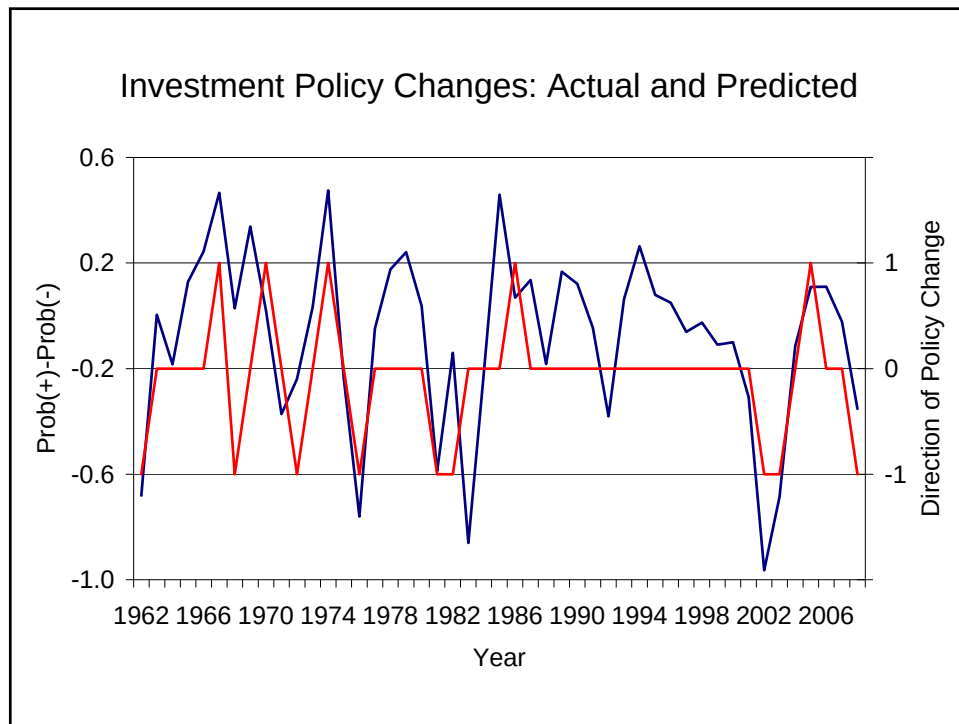
Changes in Investment Incentives

(t-statistics in parentheses)

Ordered Probit Analysis

Dependent Variable:
Increase/ Decrease in User Cost
by at least 0.5 percentage points

Intercept	0.654 (1.783)
Surplus (-1)	-31.800 (2.090)
Output Gap (-1)	-27.073 (2.395)
Change in Equipment Investment (-1)	182.978 (2.981)
Scaled R ²	.423
Observations	47



Stabilization?

- Hard to estimate
- Auerbach and Hassett (1992):
 - Estimated upper and lower bound impacts of changes in tax policy on the variance of investment-capital ratio
 - Found that changes in tax policy have increased the variance of the investment-capital ratio – entire range > 0

Another Issue

- Investment incentives depend on having taxable income, since they aren't refundable
- Having taxable income is procyclical, so this may undercut investment incentives
- The cyclicalities may have changed over time

Corporate Net Operating Losses

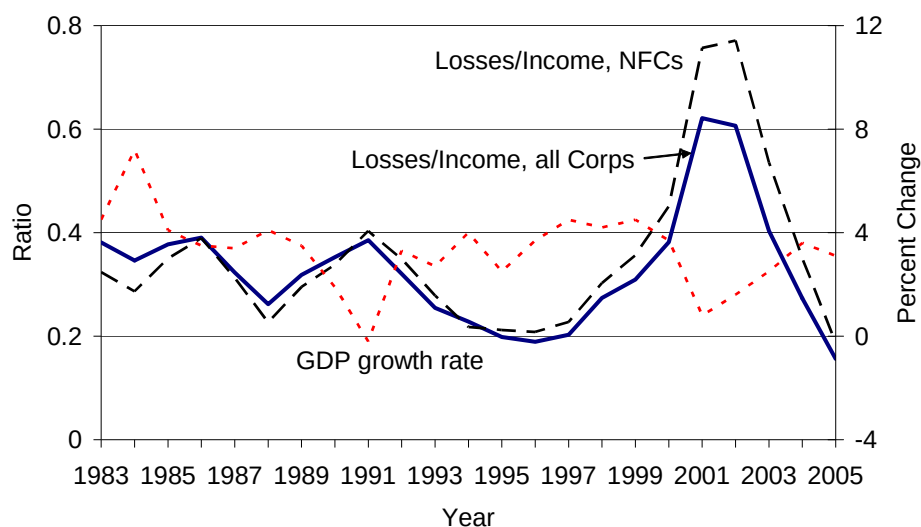


Table 4. Regressions by Tax Status, 2003 and 2004
(Dependent Variable I/K surprise)

	2003		2004	
	Taxable	No Tax	Taxable	No Tax
Mature				
CK	-0.249 [0.157]	-0.165 [0.301]	-0.113 [0.090]	1.065 [0.290]**
Immature				
CK	-0.587 [0.407]	-0.628 [0.534]	-0.395 [0.285]	-0.195 [0.424]

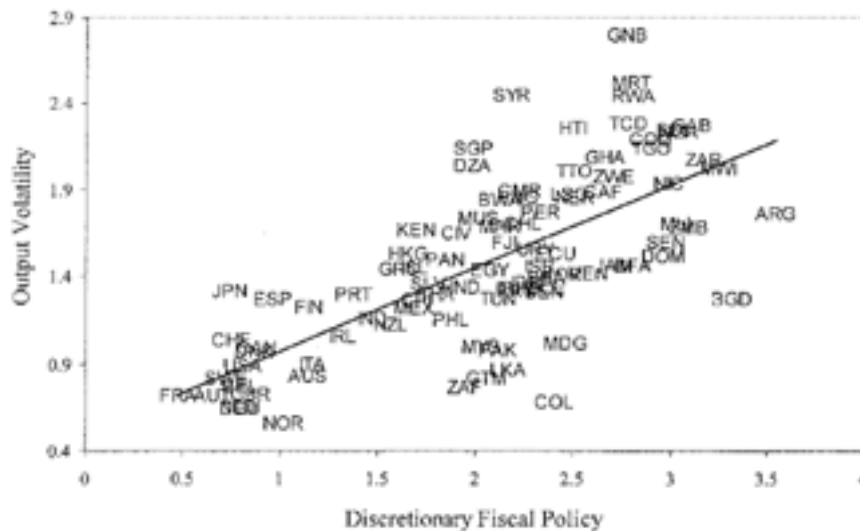
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Is Fiscal Policy Activism Good?

- Hard to tell, because hard to identify separate effects of fiscal policy activism
- Cross-country comparisons suggest the answer is no

Policy Variability and Output Variability

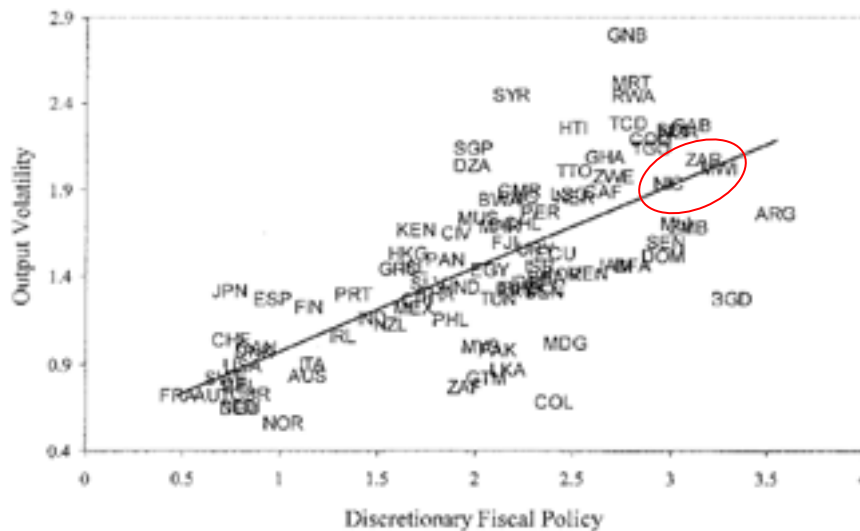


Source: Fatas and Mihov (2003), Figure 1

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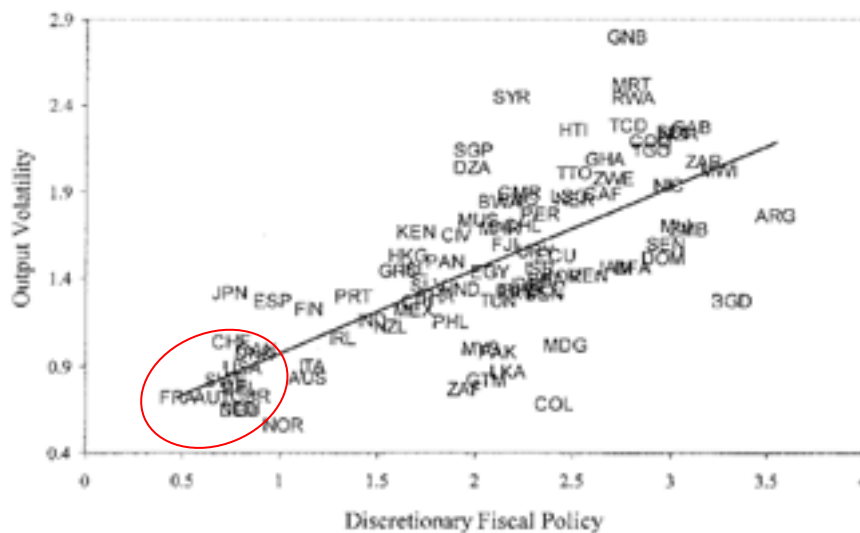
- Hard to tell, because hard to identify separate effects of fiscal policy activism
- Cross-country comparisons suggest the answer is no
- But variation in activism isn't random

Policy Variability and Output Variability



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Policy Variability and Output Variability

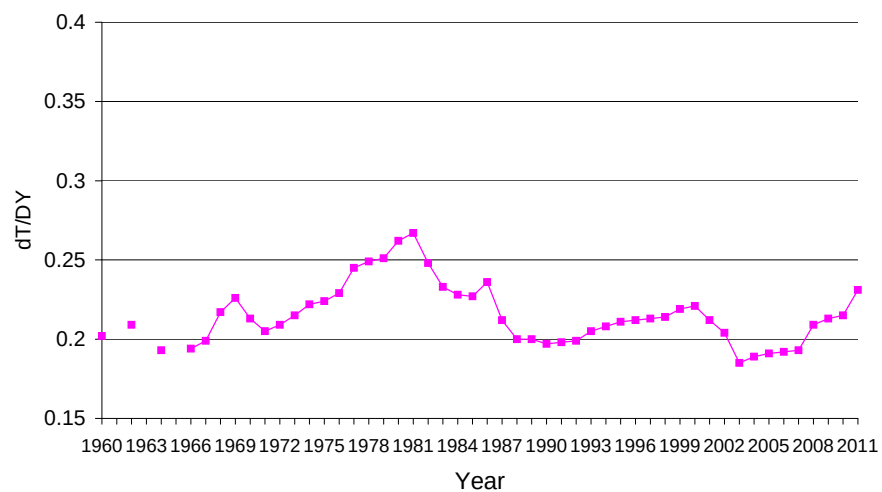


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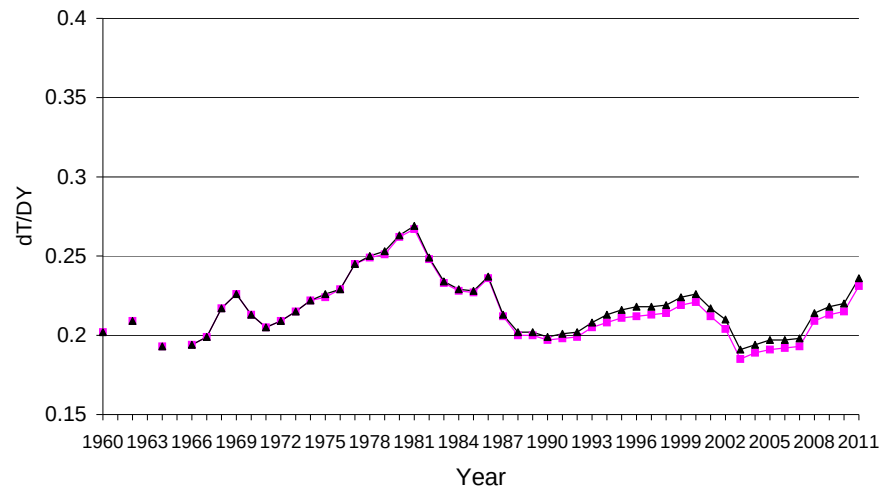
Automatic Stabilizers

- On safer ground
- But how much can they do?

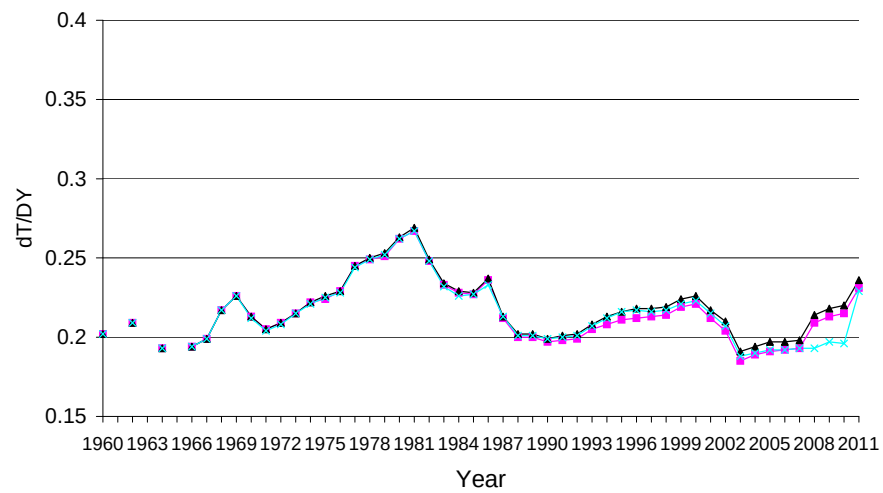
Responsiveness of Federal Taxes



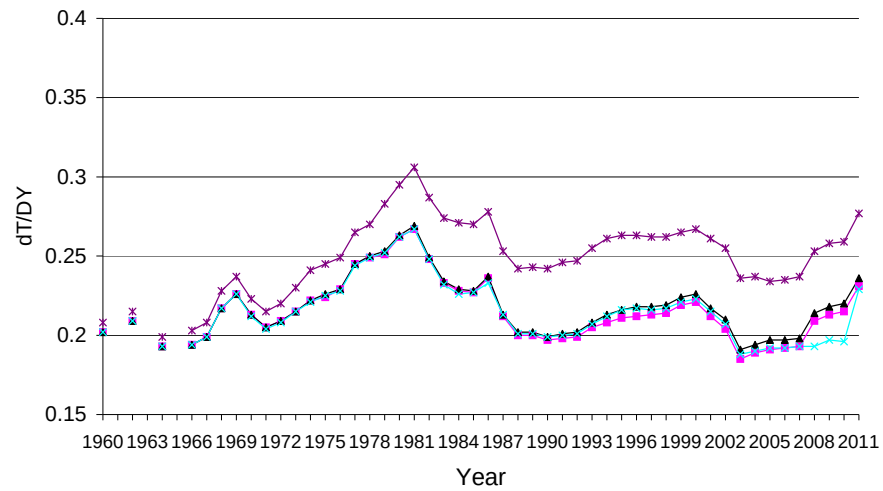
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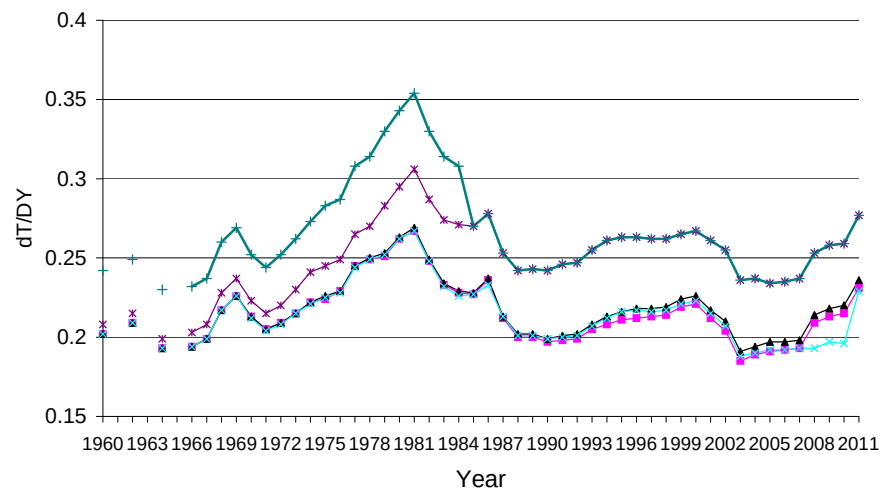
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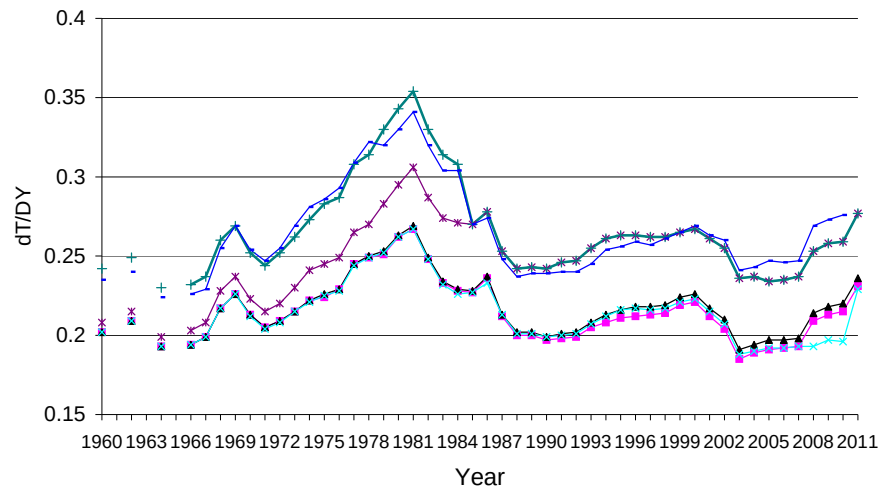
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Responsiveness of Federal Taxes



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Automatic Stabilizers

- On safer ground
- But how much can they do?
- Probably will rise in importance, but will still be less significant than in past

Summary

- Fiscal policy activism is on the rise, but at least in part because of economic conditions
- Predictable policy responses can be destabilizing, especially with respect to investment
- Automatic stabilizers are at historically low levels, but are likely to increase