Discussion of Kondo and Svec's
"Fiscal Policy Cyclicality and Growth within the US States"

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Context

- Great example of what conference is all about...
- Merits of countercyclical fiscal policy is heart of many current policy questions:
  - are BB rules stymieing state efforts to foster recovery?...does federal govt need to correct this with further aid to states?
  - was the federal stimulus package (CC fiscal policy) a good idea?
  - should deficit-reduction measures be implemented immediately or delayed until the economy has further recovered?
  - should federal govt have a balanced budget rule (could think of states with strict BBRs as providing experiment for this)?

Context

- Prior literature on merits of CC fiscal policy mostly focused on whether it reduces volatility
  - similarly...whether CC fiscal policy in downturns reduces depth of downturn (as New Keynesian models generally predict)
- But not unambiguous that lower volatility (2nd moment) alone, without an increase in growth (1st moment), improves welfare (Lucas, 1987; Wolfers, 2003)
- So this paper asks natural question:

"Does CC fiscal policy increase **growth** over long-run?"

  - Aghion & Marinescu (2007) and Woo (2009) try to answer with cross-country data – **no IV**...can offer only correlations

Key Contributions of Paper

1. (Long-ago pre-determined) BB rules restrict the countercyclicality of fiscal policy
2. Countercyclicality of fiscal policy *increases* growth

Additional Questions

- Why not look at volatility IN ADDITION to growth?
  - Fatas & Mihov (2006) do very similar cross-state IV regression of GSP *volatility* on fiscal policy cyclicality, instrumented with BB rules
  - Find NO effect of fiscal cyclicality on volatility
  - BUT…they measure fiscal cyclicality only in terms of spending – primary deficits better
- Can you separate discretionary fiscal policy from auto stabilizers?
  - Looking at statutory fiscal variables might help separate these two effects (see Reed, et al, 2011 NTJ)
- Alternative ID strategy offered by Holmes (1998)
  - Do you see spatial discontinuity in county growth when one crosses borders from strict BB rules states to weak/no BB rule states?

Additional Questions

Nice to have more on other effects of BB rules

- Are these BB rules really binding...do states with strict BB rules rarely have primary deficits?
- Can states evade BB rules by delegating to local govts?
  - Should be testable by seeing if states with stricter BB rules have larger local govt sector relative to state+local
- Can states evade BB rules by having rainy day funds?
  - Does flexibility of rainy day fund reduce effect of BB rules on fiscal cyclicality (interaction)?
- Can states evade BB rules by underfunding pension and other non-GF funds?
  - Do states with strict BB rules underfund pension plans?

Additional Questions

- What if you roll forward period over which avg. GSP growth is calculated, does effect of 77-97 cyclicality increase or decrease?
  - increase would support causal link
- Studying states holds many institutional factors constant, but adds complication of overarching federal FP that might, to some extent, offset state differences in FP.
  - Are federal transfers to states correlated with CC of state fiscal policy? BB rules?
- States are small open economies and so some of any benefits from CC fiscal policy spillover to other states
  - Look at spatial lags

Some Minor Critiques

- Need more discussion of direction of bias, ex-ante and ex-post
- OID test very low power – the five BBR instruments sink or swim as a group
- Why not extend past 1997 (SIC to NAICS switch shouldn't really affect total state GDP)?
- You give policy prescription that state govts should relax BB rules
  - But states need not relax BB rules. They can make fiscal policy more CC by other means, such as utilizing rainy day funds.

Conclusion

- Important topic, important policy debate
- Cliffhanger ending!
  - "We conclude by highlighting one possible route for future research. The current analysis studies whether the cyclicality of fiscal policy promotes growth within the US states, using the aggregate..."
  - ?????
  - Always leave the audience wanting more...