

# Discussion of “Can Deficits Finance Themselves?”

by Angeletos, Lian and Wolf

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The opinions expressed in this discussion are those of the author and do not reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.

# Summary

- ▶ Deficits can finance themselves in a model:  
**lack of Ricardian equivalence** and **Nominal rigidity**.
  - ▶ Discount future tax changes;
  - ▶ Front load spending.
- ▶ Deficits can be *fully* financed if fiscal adjustments are sufficiently delayed.
  - ▶ Self-financing is predominantly through tax base.
- ▶ This paper provides a simple framework with closed-form solutions:
  - ▶ Transmission carries over to richer model structures.
- ▶ Very elegant paper with important contributions to the literature.

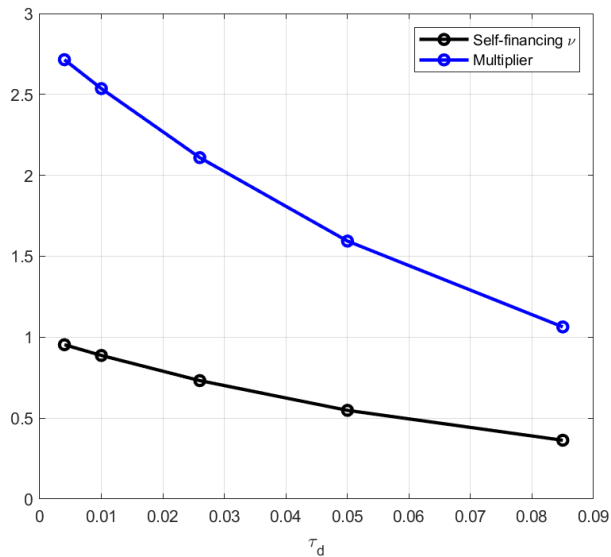
# Comment: Fiscal Multipliers

- ▶ What makes the (full) self-financing results possible?
- ▶ (Very) large fiscal multipliers.

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- ▶ What makes the (full) self-financing results possible?
- ▶ (Very) large fiscal multipliers.
  - ▶ Self-financing is predominantly through tax base.
  - ▶ Sufficient expansion in tax base → sufficient increases in tax revenue to pay off debt without increases in tax rate.
  - ▶ Further delayed fiscal adjustments → larger fiscal multipliers → higher self-financing share.

# Comment: Fiscal Multipliers



# Comment: Monetary Policy

- ▶ The size of fiscal multiplier depends on monetary policy.
- ▶ Baseline assumption: (expected) real rate is fixed.

$$(MP) \quad r_t \equiv i_t - E_t \pi_{t+1} = 0$$

$$(PC) \quad \pi_t = \kappa w_t + E_t \pi_{t+1}$$

$$\rightarrow \quad i_t = \frac{1}{\beta} \pi_t - \frac{\kappa}{\beta} w_t$$

(Compared to standard Taylor rule:  $i_t = \psi \pi_t + \phi y_t$ )

- ▶ Weakly 'active' monetary policy  $\psi = \frac{1}{\beta} > 1$ .
- ▶ Nominal rate goes down when marginal cost goes up.

# Comment: Monetary Policy and PC

- ▶ The paper discusses the importance of monetary policy and the slope of Phillips Curve.
- ▶ Alternative assumption in the paper:  $i_t = \psi\pi_t$

$\kappa$ \ $\psi$	1	1.25	1.5
0.01	1	1	0.96
0.02	1	0.72	0.43
0.1	1	0.22	0.13

Table 2: Maximal degree of self-financing  $v_{max}$  as a function of  $(\psi, \kappa)$ .

- ▶ More 'active' monetary policy as well as a steeper PC  $\rightarrow$  lower self-financing share.

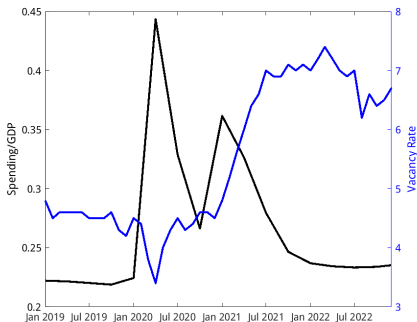
# Comment: Policy Relevance

- ▶ How likely can we implement such a policy?
- ▶ One-off (emergency) fiscal spending seems most relevant.
  - ▶ COVID fiscal stimulus
  - ▶ WWI war spending

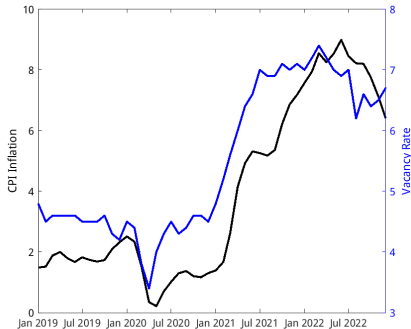


# Event: COVID

- ▶ Massive fiscal relief followed by a rapid tightening in labor market as well as a sharp increase in inflation.



(a) HWI and Fiscal Spending

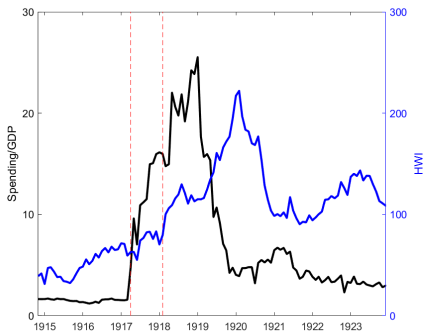


(b) HWI and CPI

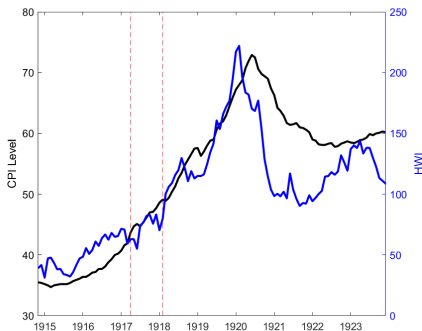
Source: FRED

# Event: WWI and Spanish Flu

- ▶ Massive war spending and Spanish Flu followed by a rapid tightening in labor market as well as a sharp rise in price level.



(a) HWI and Fiscal Spending



(b) HWI and CPI

Source: Bi, Petrosky-Nadeau, Traum, Woodward (2024), FRED

# Comment: Unfunded Fiscal Expansion

- ▶ Related to the literature on unbacked/unfunded fiscal expansions:
  - ▶ Jacobson, Leeper, and Preston (2024): “emergency” spending by Roosevelt in 1930s.
  - ▶ Bianchi, Faccini, and Melosi (2023): ARP Act in 2021.
- ▶ Transmission mechanism is different in this paper.
  - ▶ Monetary policy is active: real rate is fixed.
  - ▶ Fiscal policy is passive: expect future tax increases (which may not needed however).

# Conclusion

- ▶ A thought-provoking paper!
- ▶ It offers policy makers an “easier” fiscal policy prescription.
- ▶ More suitable in an economy with liquidity trap than one with supply constraints.