

Discussion of:  
**Interaction of government tiers and central  
banks in a federation: an empirical test**

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# What Is This Paper About?

- ▶ (Dis-)Aggregation of German government entities and empirically testing the FTPL
- ▶ Test relies on a two-pillar strategy: IRF of debt ratio on surplus shock and autocorrelation of surplus shock
- ▶ Some regional entities run active fiscal policy, rendering regional fiscal policy active in total
- ▶ Equilibrated by passive behavior of federal government

# (Dis)Aggregation - How to think about it

Horizontal vs. vertical:

$$b_t = \frac{1}{\beta}(b_{t-1} + r_{t-1} - \pi_t) + \frac{G}{B}g_t - \frac{T}{B}t_t$$

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- ▶ would be interesting what instruments guarantee (or don't) a passive fiscal policy of each tier



# (Dis)Aggregation - Issues

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- ▶ Deficits for Hamburg, Bremen and Berlin are consolidated with their respective municipalities
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- ▶ Missing out on various reforms and different distribution of fiscal duties

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## 2. Economics

- ▶ Why stop at regional level? What about municipalities? Might reverse passive to active once again
- ▶ maybe implicitly desired (or at least) incentivised that one tier is running passive policy

⇒ Moral hazard between regional and federal level?!

# Is the methodology right?

I take as Data Generating Process a New Keynesian variant of Smets, Wouters (2003) with a fiscal sector.

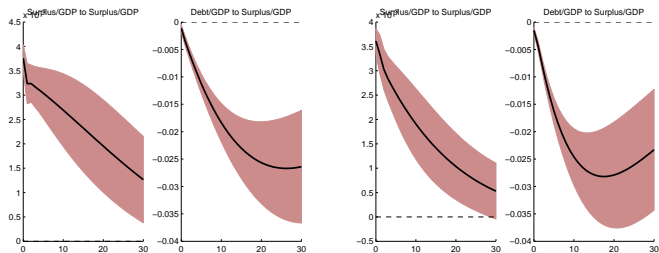
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2. Passive Monetary Policy, Active Fiscal Policy → FTPL approach or fiscal dominance

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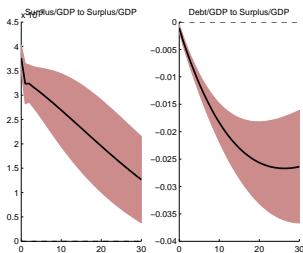


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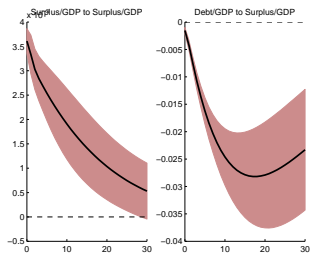
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1. Step: IRF analysis of a surplus/GDP shock in VAR:



Monetarist



FTPL

# Is the methodology right?

2. Step: Autocorrelations of surplus/GDP (univariate):

Lag	FTPL		Monetarist	
	Autocorrelation	t-value	Autocorrelation	t-value
1	0.944	27.219	0.969	42.68
2	0.930	10.679	0.844	9.700
3	0.714	7.648	0.623	6.674
4	0.576	5.869	0.543	5.584
5	0.521	4.996	0.432	4.402
6	0.483	4.726	0.409	3.878
7	0.429	4.051	0.422	3.926
8	0.398	3.660	0.417	3.954
9	0.377	3.440	0.428	3.885
10	0.364	3.247	0.470	4.670

▶ Other opinions/reasons

# Why you shouldn't use the methodology

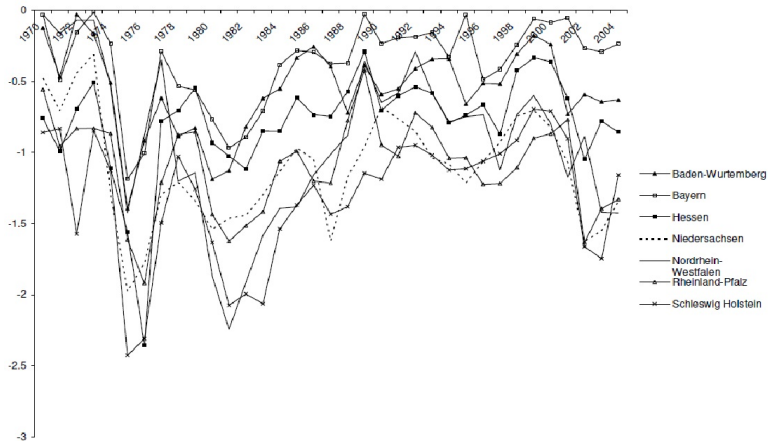
- ▶ Assumption of No default! Two Länder of your series defaulted...
- ▶ all Länder display only deficits (federal surplus only in the first few years) ▶ Deficits
  - ▶ econometrically still possible
  - ▶ intuitively rendered ad absurdum (think about  $E_t \sum_{j=0}^{\infty} i_{t,t+j} s_{t+j}$ )
  - ▶ agents would have to expect actual surpluses to overcompensate the last 35 years
- ▶ Assumption of permanent active monetary policy → then not a test on FTPL but just if any variable (eg. debt) is explosive

# Minor(Other) Points

- ▶ What about price levels of different regions?
- ▶ New evidence that maturity structure seems to be important
- ▶ Differences may come from the fact who is the owner of the debt (Sustainability issues)
- ▶ Where is the role of interaction (key focus is clearly on fiscal stance)?
- ▶ What conclusion do you draw for the EMU?
- ▶ Abstract promises more than you deliver.



# Deficits - Some Regions



▶ Back

# Is the methodology right?

What others think about the methodology:

- ▶ Davig, Leeper (2010): Some authors have studied equilibria in which debt is not bounded in order to argue that monetarist/Ricardian equilibria are, in some sense, "general" (McCallum (1984), Canzoneri et al.(2001)). Those equilibria fall apart, however, under the plausible assumption that the **government does not have unlimited access to non-distorting taxes**.

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- ▶ Cochrane (1998): The response function sign prediction requires a **different surplus driving process, not a difference in regimes**.

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