

Fiscal Calculus in a NK Model with Matching Frictions by Alessia Campolmi, Ester Faia and Roland C. Winkler

Discussant's Comments – Paul Levine

Summary

- A very neat paper!
- Demonstrates the need to model labour market frictions (LMF) properly in NK models before studying fiscal policy
- Fiscal Multiplier effects of a government spending aggregate demand shock in a model with LMF \ll those in a standard NK model
- But a fiscal stimulus aimed at reducing frictions has a large multiplier effect
- Why? effects of an increase in the real wage are crucial

$$\begin{aligned} \text{real marginal cost} &= \underbrace{\text{effective real wage}}_{NK} \\ &+ \underbrace{\text{term} \propto \text{future value of a match}}_{\text{Search Match}} \end{aligned}$$

- Lets first look at a RBC model and then a standard NK model (See dynare simulations)

Related Papers

- 1 Cogan, Cwik, Taylor and Wieland (2009), New Keynesian versus Old Keynesian Government Spending Multipliers, WP No. 1090(CCTW).
- 2 Cwik and Wieland (2009), Keynesian Government Spending Multipliers and Spillovers in the Euro Area CEPR DP No. 7389 (CW).

Examines fiscal multipliers in the SW model (capital and sticky wages) - below but close to unity \gg the NK model in CFW.

- 3 Furceri and Mourougane (2009), The Effects of Fiscal Policy on Output and Debt Sustainability in the Euro Area: A DSGE Analysis, mimeo, OECD, (FM).

Examines supply-side friendly fiscal stimulus with credit-constrained households \Rightarrow larger multipliers.

Modelling Issues

Model is the workhorse NK model with no capital with the MP search-match determination of the real wage and job creation.

- ① Fixed exogenous job separation
- ② One-period wage contracts - extension to staggered (Calvo-type) bargained contracts as in Thomas (2007)?
- ③ Nash bargaining - does it capture labour market flexibility seen in some countries?
- ④ Quibble: Separable utility function with $\sigma > 1$ incompatible with a balanced growth path (But see Levine, Pearlman, Perendia and Yang (2010) for a non-separable utility function!)

Other Issues

- ① Are the conclusions too negative regarding the conventional fiscal stimulus?
 - Multipliers don't need to exceed unity to do a stabilization job
 - With interest rate peg results look quite good!
- ② Non-Ricardian Effects
 - Learning rather than or alongside RE - See Levine et al (2010)
 - Credit Constraints (Goodfriend and McCallum (2007))
- ③ Supply-side fiscal expenditure as in FM
- ④ The design of automatic stabilizers (see Blanchard et al, IMF)
- ⑤ These types of exercises are very important to withstand the back-lash against formal modelling.