

Discussion

Fiscal Policy and the Distribution of Consumption Risk

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Summary of the Paper

- Bansal and Yaron meet Romer + Labor Tax
- Countercyclical fiscal policy combined with endogenous long-run risk increase welfare cost

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Outline

- 1 Model
- 2 Fiscal policy
- 3 Calibration

The Model

- Household: Epstein-Zin preferences with elastic labor
- Endogenous growth (Romer 1990)

$$\begin{aligned}\text{Growth} &\approx f(\text{market value of future profits}) \\ &= f(\text{discount rate, labor})\end{aligned}$$

- 1 cash flow channel (profit)
 - 2 discount rate channel
- Fiscal policy: *smooth* labor through tax and government debt

The Mechanism

1. Intertemporal substitution between labor tax and government debt

$$\left\{ \begin{array}{l} \text{govn expenditure } \uparrow \\ \text{productivity } \downarrow \end{array} \right\} \implies \left\{ \begin{array}{l} \text{labor tax } \downarrow \\ \text{public debt } \uparrow \end{array} \right\} \implies \{\text{long-run profit } \downarrow\}$$

The Mechanism

2. New: Intertemporal substitution between short-run and long-run consumption risks

$$\{\text{smoothing labor}\} \implies \left\{ \begin{array}{l} \text{short-run risk } \downarrow \\ \text{long-run risk } \uparrow \end{array} \right\}$$

$$\implies \left\{ \begin{array}{l} \text{market value of future profits } \downarrow \\ \text{growth } \downarrow \end{array} \right\} \implies \text{higher welfare costs}$$

Fiscal Policy

Countercyclical fiscal policy = *procyclical* labor tax + countercyclical debt

- Is the *procyclical* labor tax here Ramsey optimal?
 - Ramsey problem: Smooth taxes
 - This model: Smooth labor
- Ramsey optimal labor tax in *exogenous* growth model - **constant**
 - Lucas and Stokey 1983; Chari, Christiano, and Kehoe 1991, 1994;
 - What happens if tax is constant - tax smoothing?
 - Weaker result on welfare cost?
- Ramsey optimal labor tax in *endogenous* growth model with time-separable preferences - **zero**
 - Bull 1992; Jones, Manuelli, and Rossi 1997
- This model: continuation value in Epstein-Zin preferences may matter for optimal tax

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Calibration

Labor market statistics are missing

- Volatility of labor (hours) and wage rate
 - Procyclical tax may imply too smooth hours and too volatile wage
- Volatility and cyclicalty of government debt

$$\begin{aligned}\frac{B_t^G}{Y_t} &= \rho \frac{B_{t-1}^G}{Y_{t-1}} + \epsilon_{B,t} \\ \epsilon_{B,t} &= \phi_B (\log L_{SS} - \log L_t)\end{aligned}$$

Calibrate ϕ_B to match the debt dynamics

- Is debt-GDP ratio stationary?

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Quantity of Risk

- Long-run risk only picks up price of risk. What happens if we match quantity of risk?
- Needs sticky wages (Favilukis and Lin 2012)
 - the discount rate channel will be strengthened
 - the issue of volatility of hours/wages would be mitigated
 - even larger welfare cost?

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Conclusion

Very interesting paper!

Would be nice to see fiscal policy connected to Ramsey optimal tax