

The effects of fiscal foresight shocks

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Background and Research question

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Paper Question

Under what conditions do foresight shocks matter?

The econometric problems of foresight

Invertibility of a simple MA(1) model

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- This implies that the MA(1) is invertible if $|\beta| < 1$

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Take home from invertibility

Invertible and non-invertible process renders the same moments.

Non-invertibility requires future information which the econometrician does not have.

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 - ▶ **Spending foresight - incorporate news**

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GLV transmission mechanism

$G \uparrow, L^d \uparrow$ at any given wage, $C^0 \downarrow$ due to Ricardian nature, $N \uparrow$ due to increased firm output, $W \uparrow$ due to mark-ups required by unions, $C^r \uparrow$ due to wealth effects

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 - ▶ **Foresight = $0.59\varepsilon_t + 0.24\varepsilon_{t-1} + 0.09\varepsilon_{t-2} + 0.08\varepsilon_{t-3}$**

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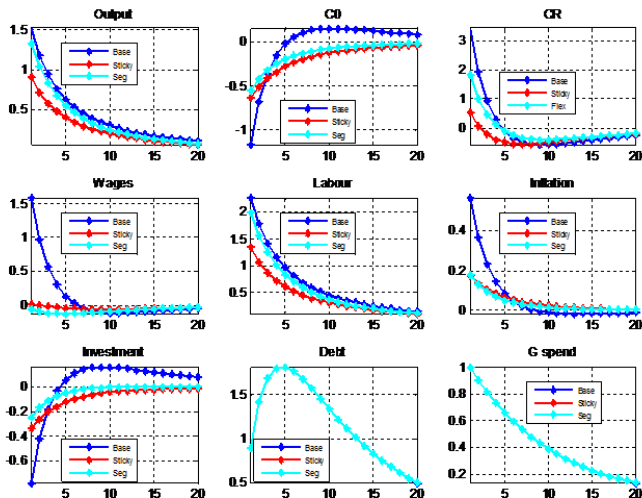
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- ▶ $r_t = r + \phi_\pi \pi_t$

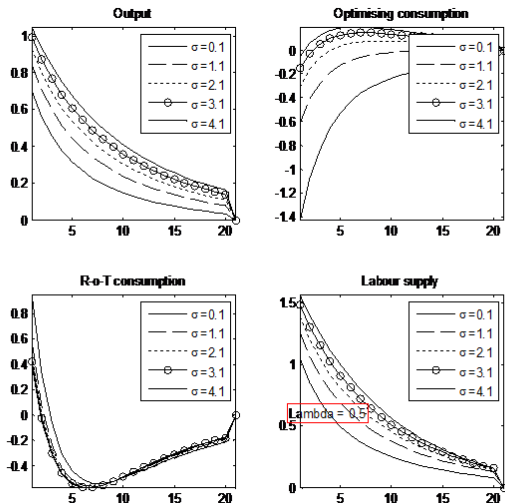
Results

A comparison of the different models



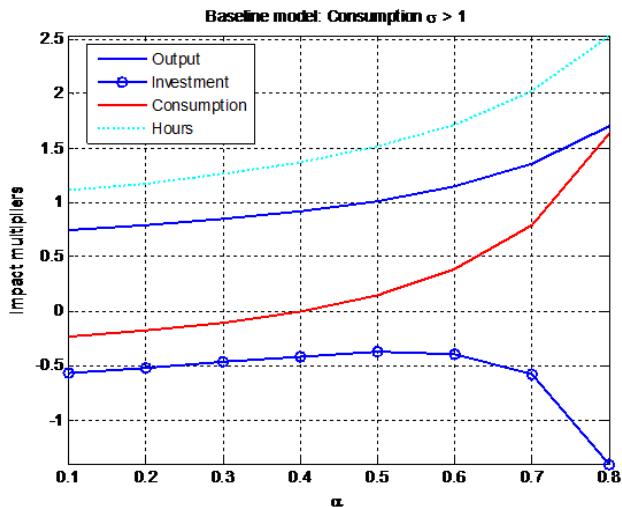
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The role of the utility function



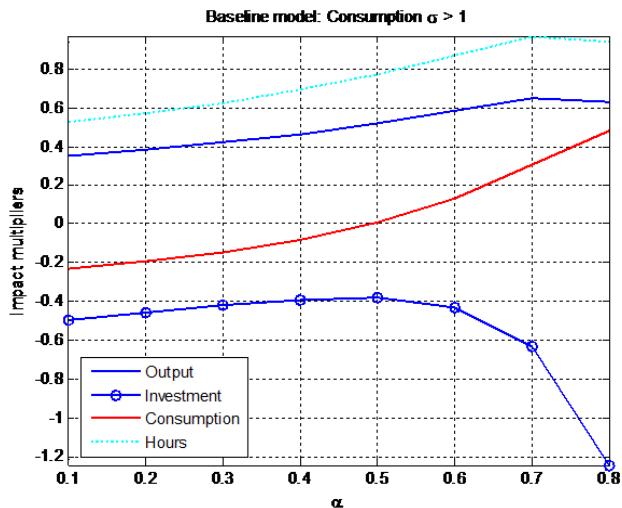
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Impact multiplier - elastic labour supply



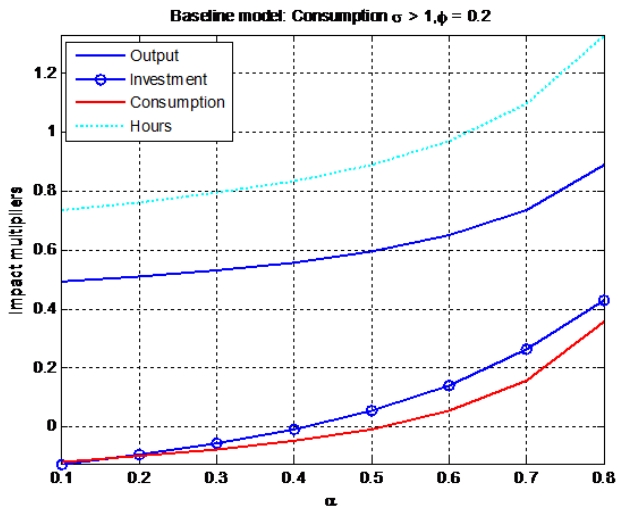
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Impact multiplier - elastic labour supply + foresight



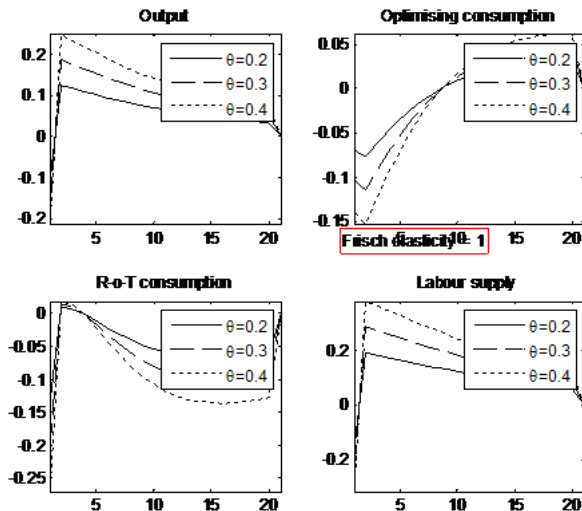
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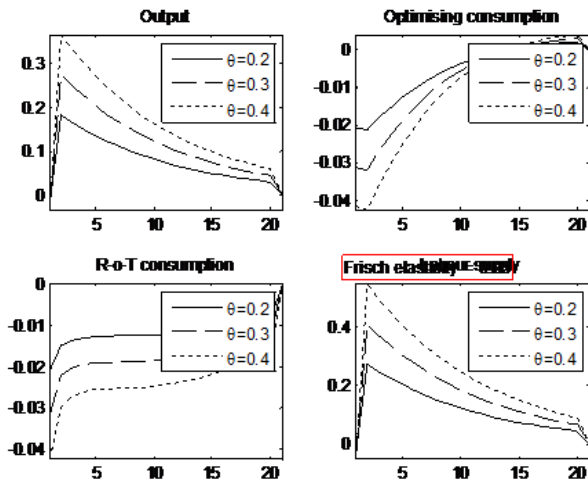
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Foresight under elastic labour supply - perfect comp. labour market



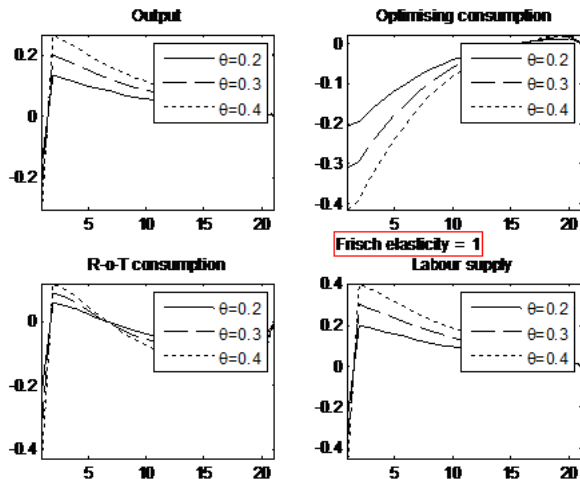
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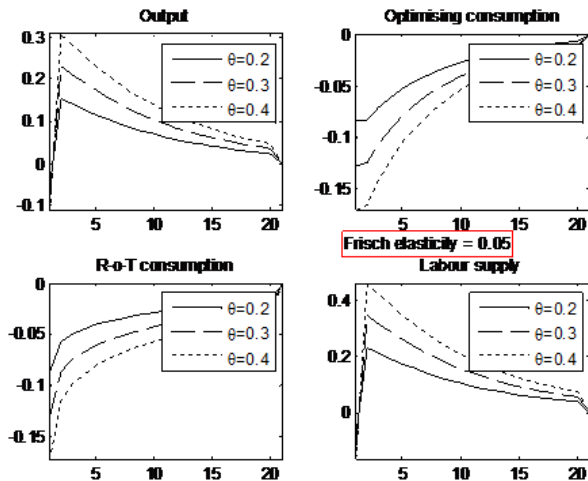
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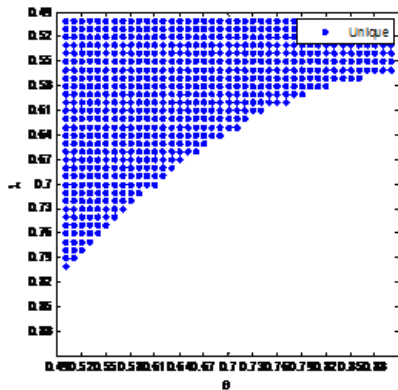
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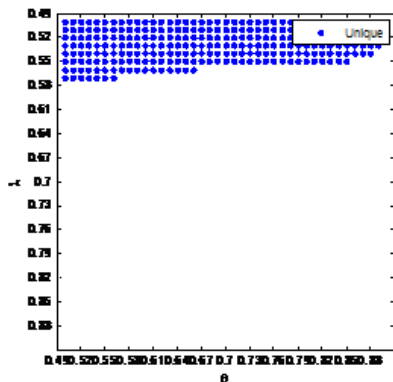
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The effects of fiscal shocks are constrained in a RE framework - baseline model



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The effects of fiscal shocks are constrained in a RE framework - sticky wage model



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 - ▶ The labour supply elasticity
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- The multiplier is constrained by a grid of parameters
 - ▶ The model becomes indeterminate at high R-o-T share
 - ▶ The model becomes indeterminate at very slow price adjustments
- Income and substitution effects are important and can explain away high elastic labour supply