"The Effects of Government Spending in the Eurozone" by Gabriel, Klein and Pessoa, 2021

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* The views expressed in this presentation are those of the author and should not be attributed to the IMF, its Executive Board, Management or staff.

Summary I

- Paper exploits a new detailed **regional dataset** to provide empirical evidence on fiscal transmission **in euro area (EA) – discretionary FP**

- **Regional "relative open economy multiplier"** [Nakamura and Steinsson, 2014, Bernardini et al.2020] - new evidence for EA, combining methodology

- **A very rich and nicely executed analysis**
  - Effects of G shocks on regional output, investment and labour mkt variables
  - Sectoral results and state-dependent analysis
  - Robustness checks (fiscal foresight, sample changes, different versions of instruments)

Summary II

Main takeaways:

- Multipliers are large, larger in busts
- Demand and supply side effects: ↑ durable C, ↑ investment , ↑ productivity, ↑ labour share and new jobs in private sector
- Multipliers are symmetric (fiscal expansions = consolidations)
- **Multiplier larger in core EA countries than periphery**
- **Spillovers are small** (in contrast to literature, e.g. Alloza et al. 2020)

Comments I

- **EA is a monetary but not a fiscal union** – FP reaction function, financing and related constraints differ across countries
  =>> *tax revenues and sovereign risk premia included as controls*
  - Tax receipts are endogenous – rather look at changes in tax rates
  - Foreign vs domestic investors - Broner et al. (2021) show that multipliers are increasing the share of foreign financing, could explain higher multipliers in core countries + small spillovers (negative effects of fin. linkages).
- **Multipliers cannot be simply aggregated to national ones** – this could be stressed more in the paper + mention “regional” in the title?

Comments II

- **Investment impulse response** - no time to build

- **Controlling for fiscal foresight –** challenging with annual data
  - Blanchard-Perotti approach less satisfactory as European semester implies updates twice a year (structural break in 2010?)
  - Professional forecast errors in principle better (but F-stats for the strength of the instrument below critical value)

Policy implications

- **For fiscal policy coordination at European level?**
  - Redistribution of spending to regions with higher relative multipliers can stimulate aggregate economic activity [Bernardini et al., 2020]
  - Larger multipliers (and fiscal space) in core countries **but** small spillovers!
- **For risk-sharing?**
  - Multipliers larger in busts – support the EA fiscal stabilization function
  - Small spillovers weaken the argument

=>Spillovers by group of countries/state of the economy?