“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


- **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
  
  \[\Rightarrow\] 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?