

DISCUSSION OF
“Optimal Monetary and Fiscal Policy at the ZLB in a
Small Open Economy”
by Saroj Bhattarai and Konstantin Egorov

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Federal Reserve Bank of New York

NBHEC Workshop

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The Title Says It All, or Not...

- Optimal: Ramsey/Commitment and Markov Perfect/Discretion
- Monetary: i_t
- Fiscal: G_t with $g(G_t)$ in the utility function
 - Many choices possible here
- At the ZLB: $i_t \geq 0$ with sticky prices and hence non-neutral monetary policy
- In a SOE: not your undergrad textbook's, but Galí and Monacelli (2005)
 - an open economy that imports from and exports to the ROW, but has no effect on it
 - “other than that”, a standard New-Keynesian economy

Two Distortions

- Monopolistic competition (i.e. markups) and terms of trade manipulation motive
- The subsidy needed to make the steady state efficient

$$1 + s = \frac{\varepsilon}{\varepsilon - 1} \left[(1 - \alpha) - \eta\alpha \frac{(2 - \alpha)}{[1 - \alpha]} (C + G) \frac{u_{CC}}{u_C} \right]^{-1}$$

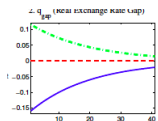
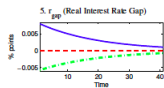
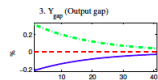
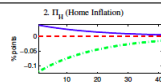
- Depends on
 - ε : markup
 - α : openness/home bias
 - η (and σ): elasticity of subs between home and foreign good
 - G : fiscal policy

The Basic Dynamic Trade-Off

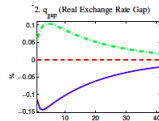
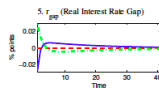
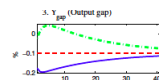
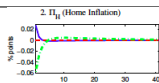
- Technology shocks have a cost-push component: trade-off



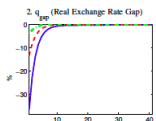
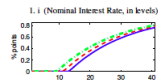
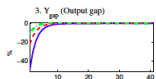
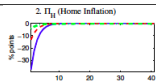
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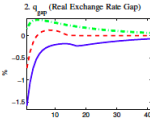
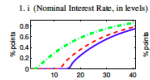
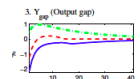
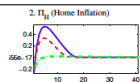
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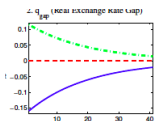
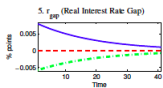
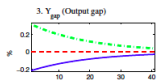
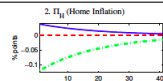


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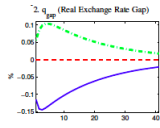
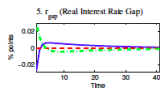
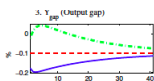
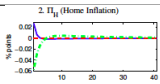


Fiscal Policy

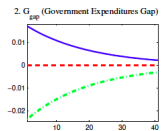
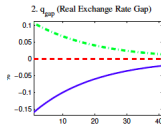
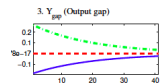
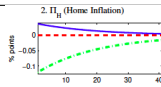
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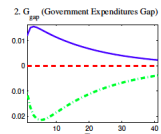
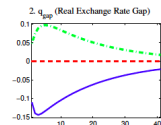
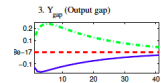
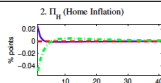
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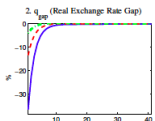
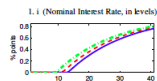
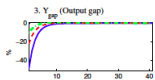
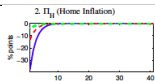


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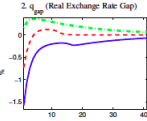
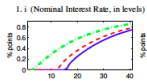
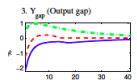
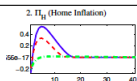


Fiscal Policy at the ZLB

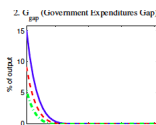
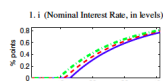
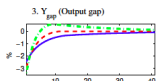
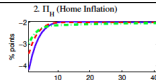
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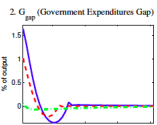
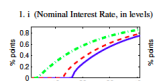
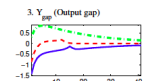
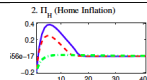
Commitment



Discretion



Commitment



Conclusions

- Nice contribution to the literature on optimal policy at the ZLB
- Some discussion of its empirical relevance would be welcome
 - Which Countries have or have not followed these prescriptions? What can we learn from their experience?
- Some tension between optimal monetary and fiscal/ZLB/SOE skins
- To ease some of that tension I would suggest
 - More explicit treatment of marginal role of fiscal policy
 - Look at other shocks (β_t): technology shock seems like an odd choice as a source of ZLB
- Could this be a source of identification for the sneaky elasticity η ?