Discussion

"Fiscal Management of Aggregate Demand: The Effectiveness of Labor Tax Credits"

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Joint ECB-IMF-IMFER Conference 2024

Global Challenges and Channels for Fiscal and Monetary Policy

Frankfurt, July 23–24, 2024

Overview

This paper:

Uses HANK model with unemployment risk to "to analyze the effectiveness of several fiscal policies in stabilizing a demand-driven recession."

First things first:

- Very topical question answered with state-of-the-art tools
  - $\rightarrow$ feature rich and carefully calibrated HANK model
  - $\rightarrow$ sensible horse race between stabilization policies

Plan for this discussion

- Brief summary

- Comments $+$ suggestions

One-slide summary

1. What they do:

   - Quantitative HANK model with rich fiscal sector, extensive-margin labor supply decision, and counter-cyclical unemployment risk

   - Model economy hit by preference shock that causes demand-driven recession

   - Horse race: i) targeted transfer (TT) to low income (employed + unemployed), ii) UI top-up, and iii) labor-tax credit (TC) for employed workers
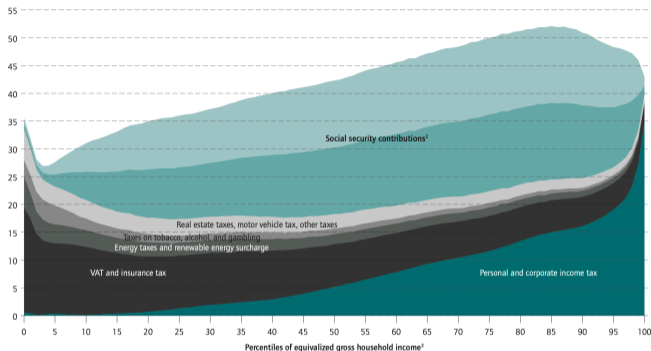
2. What they find:

   - All three packages stabilize demand-driven recession
     $\rightarrow$ TC more effective in stabilizing output and less inflationary

   - Key: all packages work through consumption channel, but TC has additional labor-supply channel

Comment # 1: Labor taxes for low-income households

Taxes and social security contributions as percent of gross household income, 2015[1]
Integrated data base (SOEP, EVS, income tax statistics)

55
50
45
40
35
30
25
20
15
10
5
0

Social security contributions[2]

Real estate taxes, motor vehicle tax, other taxes
Taxes on tobacco, alcohol and gambling
Energy taxes and renewable energy surcharge

VAT and insurance tax

Personal and corporate income tax

0 5 10 15 20 25 30 35 40 45 50 55 60 65 70 75 80 85 90 95 100

Percentiles of equalized gross household income[3]

1 Polynomial fitting.
2 Half apportionment of social security contributions.
3 Equivalized by new OECD scale.

Source: Integrated Data Base (SOEP, EVS, income tax statistics); projected to 2015.

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TC package: transfer to working poor

$\rightarrow$ depends on positive labor income

$\rightarrow$ incentivizes work

Interpret as equivalent to labor tax cut for low-income households

$\rightarrow$ does this work at bottom of distr.?

$\rightarrow$ e.g., Germany: high progressivity

$\rightarrow$ bottom third pays no income tax

Authors cite Zidar (2019, JPE)

$\rightarrow$ het. effects of income tax changes

$\rightarrow$ but, here: low-income = bottom 90%

Comment # 2: Distributional effects and normative implications

- Presented model features rich heterogeneities
  - $\rightarrow$ but paper only discusses responses of macroeconomic aggregates
  - $\rightarrow$ understandable given focus on "aggregate" stabilization
- Still would be interesting to look a bit into heterogeneity
  - $\rightarrow$ responses of unemployment/wages for income groups?
  - $\rightarrow$ top-10 income/wealth shares, consumption gini?
- Nice to have: some idea of welfare implications

Comment # 3: Not every recession is the same

A) Initial claims
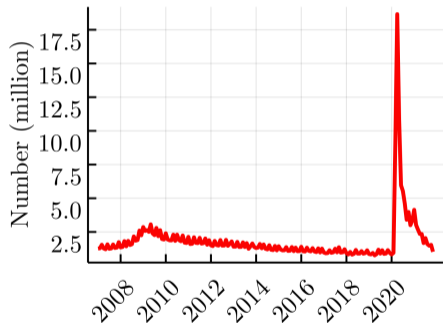
Simulation: pref. shock-induced demand-driven recession

$\rightarrow$ (btw: why such a small shock?)

$\rightarrow$ TC: labor supply channel is key

There might be crises where this channel is muted

$\rightarrow$ extreme case: lockdowns in the pandemic

$\rightarrow$ simulate different forms of recessions

$\rightarrow$ or at least discuss this a bit

Comment # 4: Practical implementation

- Fiscal policy has rich set of tools for business cycle stabilization

  $\rightarrow$ but how do we implement them efficiently?

- Often employed in a very discretionary manner

  $\rightarrow$ e.g., CARES Act increased and extended UI benefits (FPUC, PEUC,...)

  $\rightarrow$ subject to political economy issues ("polarization") and implementation lags

- Authors briefly mention idea of tax rule, where "labor taxes respond systematically to the state of the economy"

  $\rightarrow$ might also be politically controversial: time-varying progressiveness

  $\rightarrow$ what observables to include in rule?

  $\rightarrow$ hard to decide on right instrument ex-ante $\rightarrow$ paper makes some progress here

Comment # 5: Miscellanea
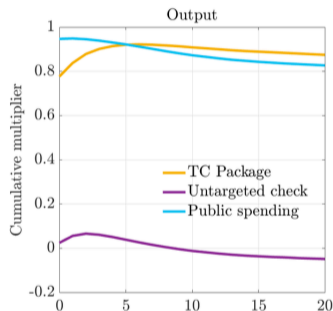
1) What is going on with the G multiplier?

$\rightarrow$ seems large given "large crowding-out of private consumption"

2) Potentially relevant paper:

"Welfare and Spending Effects of Consumption Stimulus Policies"

Carroll, Christopher, Edmund Crawley, Ivan Frankovic, Håkon Tretvoll

Board of Governors Finance and Economics Discussion Series 2023-002

To sum up

Very clean exercise with high policy relevance

$\rightarrow$ my advice would be to expand the discussion at various points

$\rightarrow$ "put a little bit more meat on the bones"

Certainly looking forward to the next iteration!