Cox, Feng, Müller, Pasten, Schoenle and Weber (2024): Optimal Monetary and Fiscal Policies in Disaggregated Economies

Discussion by Luzie Thiel, University of Kassel

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General thoughts

- ▶ Very interesting paper and research question.
- ▶ Strong and important contribution to the literature.
- ▶ Convincing combination of theory (optimal policy analysis) and empirical evidence.
- ▶ Interesting results (optimal mix of monetary and sectoral fiscal policies); theoretical results supported by U.S. data.

Contributions to the literature

- Distortions through sectoral heterogeneity: related to other optimal policy analysis research with a distorted equilibrium (financial frictions, household heterogeneity, asymmetric currency unions).
- Innovative and inspiring approach to apply the Galí-Monacelli (2008) model framework (infinite amount of small countries) to k sectors.
- This paper is breeding ground for further research.

Welfare function

Eq. (3.31):

$$-\frac{1}{2}\sum_{t=0}^{\infty}\beta^t\sum_k \mu_k\left(\frac{\theta(1-\chi_k)}{\lambda_k}\pi_{kt}^2 + (1+\varphi)\tilde{y}_{kt}^2 + \chi_k^*\tilde{\tilde{f}}_{kt}^2\right)$$

- ▶ Welfare weights: What is the relative quantitative importance of each stabilization objective? E.g., based on your calibration and data?
- ▶ Steady-state sectoral size $\mu_k = Y_k/Y$:
  - ▶ What are some of the largest sectors in your data?
  - ▶ How heterogeneous are the sectors?

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▶ Calibration of $\varphi = 4$:
  ▶ φ is an important driver for the results.
  ▶ For example, φ is also included in the reaction function of fiscal policy (eq. (3.32), optimal sectoral fiscal rule) and determines labor supply.
  ▶ Would it make any difference to the results if we change this value (micro vs. macro elasticities)?

Heterogeneity of sectors

- For optimal policy analysis, we need simplifying assumptions.
- There could be some interesting possible extensions of sectoral heterogeneity.
- The model assumes **identical mark-ups (market power)** across all firms and sectors.
- If we abandon this assumption, what are the implications?

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- If we abandon this assumption, what are the implications?
- **Heterogeneous** instead of homogeneous **labor markets** across sectors:
    - Possible further development in future research work: Implementation of **wage rigidity**, e.g., heterogeneous across sectors.
    - Wage rigidity could influence how marginal costs and cyclicality of profits react to productivity shocks.

Type of shocks

- Simulation of productivity shocks, which are symmetric across all sectors.
- Since sectors are heterogeneous, the first best is not achievable for optimal policy.
- Possible add-on: **Idiosyncratic shocks** - what would the optimal policy mix look like if only some sectors were affected (e.g., Covid-19 pandemic)?

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- ▶ Possible add-on: **Idiosyncratic shocks** - what would the optimal policy mix look like if only some sectors were affected (e.g., Covid-19 pandemic)?
- ▶ **Demand shocks** in your model economy:
  - ▶ Classical answer: Optimal monetary policy is able to fully absorb a demand shock.
  - ▶ However, in your model framework, there are sectoral distortions.
  - ▶ Would optimal sectoral fiscal policy be able to fully compensate these distortions?
  - ▶ Given an optimal sectoral fiscal response to the demand shock, this would also have an impact on the Phillips curve and thus on optimal monetary policy.

Policy game - possible variations

▶ The model assumes joint optimization of monetary policy and sectoral fiscal policy and discretionary policy.

▶ The authors also provide empirical evidence supporting their theoretical results.

▶ It would still be very interesting to discuss the strategic behavior of policy makers:
  ▶ What would happen if monetary policy and fiscal policy were set separately?
  ▶ Who would be the first mover? (Nash/Stackelberg?)
  ▶ Furthermore, one could assume that monetary policy is able to commit to a policy plan, while fiscal policy acts discretionary. Implications?

Policy implications - stabilization of stickier sectors

- ▶ Optimal policy: Sectors with stickier prices are given more weight. The more distorted a sector is, the more important it is for optimal policy.
- ▶ This implies distributional effects across the sectors - is this an acceptable fiscal policy? Especially, if this redistribution is medium/long-term?
- ▶ What are the **causes of price rigidity** in the various sectors?
    - ▶ Could they arise due to misallocation, for example?
    - ▶ Are the sectors with stickier prices sectors with lower growth rates?

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▶ Beyond the scope of this paper: Does optimal sectoral stabilization fiscal policy create an incentive for sectoral lobbying?

Inspiration for future research

- The paper offers valuable knowledge and is a pleasure to read.
- Inspiring research contribution with a lot of potential.
- Ideas for possible future applications:
    - Extension to a two-country model with different sectors (add more layers).
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- Thank you so much for giving me the opportunity to discuss this great paper!