Excess Savings and Twin Deficits:
The Transmission of Fiscal Stimulus in Open Economies
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Contributions

- Methodological: characterize response to debt financed increase in transfers in open economy HANK
- Economic: explain the patterns of fiscal and external deficit in U.S. after the COVID crisis

Outline

- Put the paper in context
- Into the Non Ricardian response (as suggested by authors)
- Is the Ricardian view really at odds with data?

The HANK revolution

- Up to 10 years ago a dichotomy in macro
- HA model (Aiyagari): good theory of consumer demand (IM, idio shocks), but no effects of demand on output
- NK models (Gali): good theory of how demand affect output (sticky prices) but very stylized theory of consumer demand (RA)
- HANK (KMV, 2018 and many others) merges the two!
- Authors are pushing forward a research agenda putting HANK as the leading macro paradigm
- Support this by providing methods to solve and estimate HANK models easily
- This paper puts HANK to work in a standard open macro issue.
- I am totally a fan!

Main finding

- Consider a debt financed increase in transfers
- In a standard NK:
  - ▶ no effect on private consumption (Ricardian)
  - ▶ Domestic hholds purchase debt to pay for future taxes
- In HANK:
  - ▶ short run: private consumption up (high MPC) and debt purchases
  - ▶ medium/long run: private consumption continues to stay high, financed by debt decumulation (Spend down)
  - ▶ in the long run all debt is held by foreigners (CA deficit)

Debt ownership in small open economy
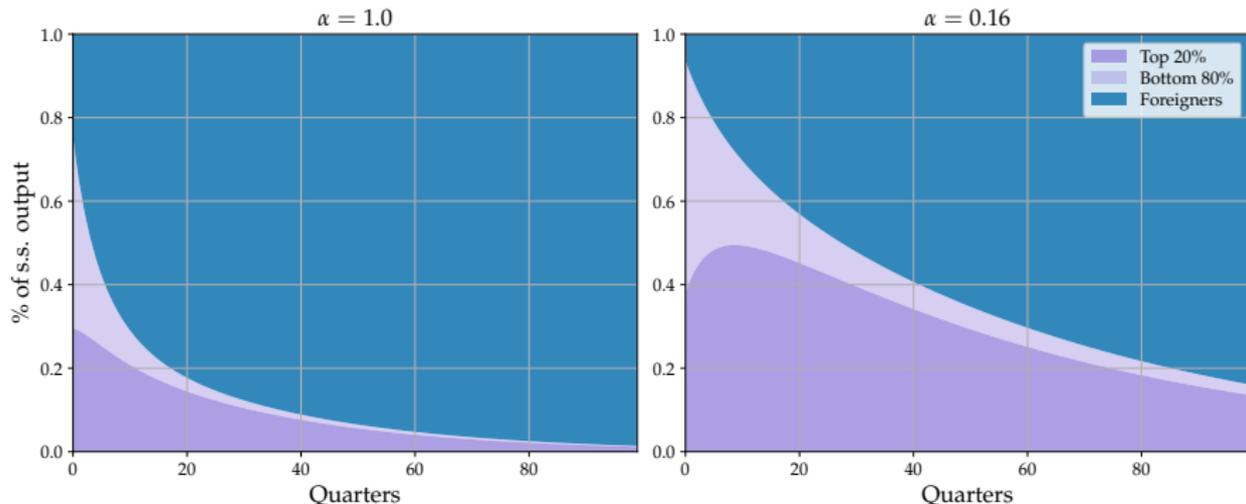
- Strong domestic consumption response (Non ricardian) leads to long run CA (Twin deficit)

Which part of the HA drives the non Ricardian behavior?

- Simplified version of the AARS model
- small open economy (r), three types $\beta_1 < \beta_2 < \beta_3 = \frac{1}{1+r}$
- each has same constant income $y = 1$, log utility
- consider a debt financed increase in transfers to all types

A debt financed increase in transfers
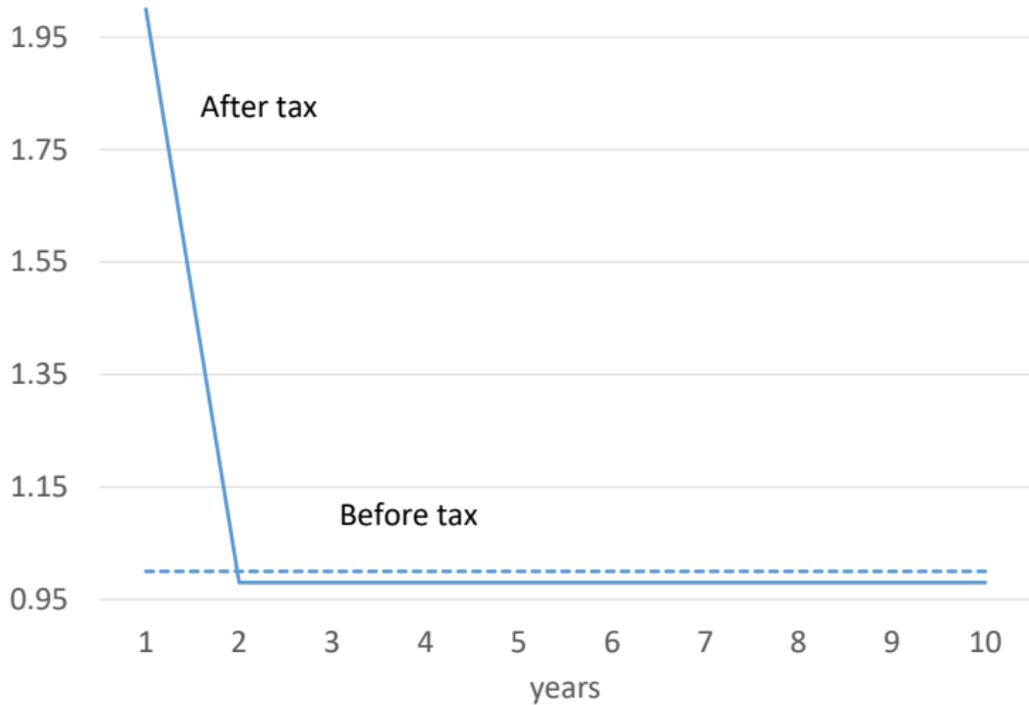
Consumption and debt holdings responses

Consumption Reponse

Debt holdings response
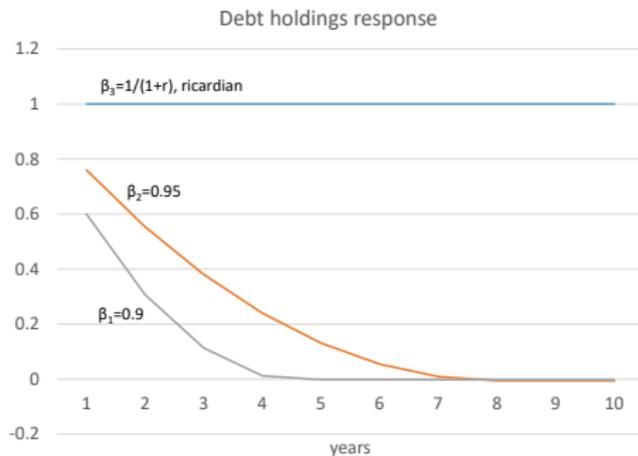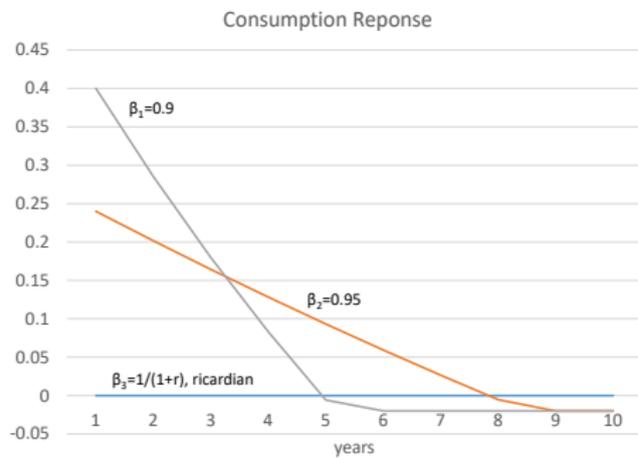
- Key feature to explain high MPC and spend down behavior is presence of impatient agents
- Little discussion of it in the paper (summarized by δ)
- Could show how sensitive are results to how many impatient agents there are and how impatient they are
- Could be estimated from data on wealth distribution

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Is the Ricardian view really at odds with data?

- Paper starts by emphasizing (long run) non ricardian responses
- Suggests that recent in CA deficits in U.S. is the result of increase in private spending fueled by transfers
- However paper ends on a different note
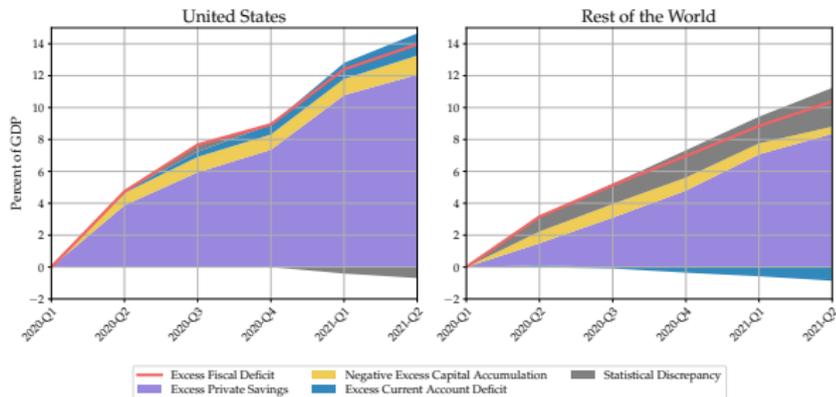
- ▶
  - ▶ *"model has limited explanatory power for current account movements."*
- Maybe open economy not essential and excess debt is held by rich domestic agents?
- If rich don't receive transfers, they would want increase their saving!

Conclusion

- Excellent paper in a very promising research agenda!
- State of the art work (both theory and data) to understand impact fiscal policy shocks
- Possibly missing some additional feature to explain recent developments in US CA (stock price dynamics?)