

DISCUSSION OF THE PAPER BY HENRIQUE BASSO AND OMAR  
RACHEDI: THE YOUNG, THE OLD AND THE GOVERNMENT:  
DEMOGRAPHICS AND THE FISCAL MULTIPLIERS

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**CEPR Conference on Growth And Inequality: Long-Term Effects Of  
Short-Term Policies**

Tel Aviv

May 15-16, 2018

- Unsettled debate among economists on the effectiveness of fiscal policy.
- Disagreement on the magnitude of the short-term fiscal multipliers and whether they are below or higher than one (Keynesian multiplier).
- This debate has been renewed by the latest financial crisis and the IMF Global Prospects and Policies report in 2012.
- Fiscal multipliers tend to be weaker than in the past (Blanchard and Perotti 2002).
- Current consensus: there is no one fiscal multiplier but many possible ones depending, for instance, on the characteristics of the economy, the business cycle and the type of fiscal instrument (Ilzetzki, Mendoza, and Vegh, 2013).

- Recently, the literature has focused on other potential factors such as wealth inequality.
- Brinca, Holter, Krusell and Malafry (2016) show that countries with high wealth inequality have larger fiscal multipliers due to stronger credit constraints at the bottom of the distribution.
- The paper by Henrique Basso and Omar Rachedi looks at the demographic dimension of wealth inequality.
- In accordance with the life-cycle hypothesis, the young have lower wealth than the old and, hence, are more credit constrained. In ageing countries, the share of those who are credit-constrained should decrease. So should the fiscal multipliers.

- The objective of their paper is to convince us that the effectiveness of fiscal policy *also* depends on demographics and that ageing should lower this effectiveness.
- To do so, they propose...
  - to estimate the effect of the share of the young population (aged 20-29) on (output and employment) fiscal multipliers at the level of US states;
  - to replicate and explain this effect with an overlapping generations model with aged-dependent Frisch elasticity of labor supply, credit constraints and incomplete bond market;
  - to simulate the model after calibrating it and quantify the three potential channels of this demographic effect.

- Strategy: use of the large variability in the shares of the young people across the US states to estimate the causal effect of demographic changes on local fiscal multipliers between 1967 and 2015.
- To minimize endogeneity issues, the authors...
  - use military spending as the fiscal instrument (considered as exogenous);
  - instrument the local fiscal shock by the product of the change in federal military spending and a state fixed effect;
  - instrument the share of the aged 20-29 by the states' birth rates a generation before (to avoid the migration effect of the fiscal shocks).

- Demographic effect on the local output fiscal multipliers is statistically significant and amounts to 3.1% (for 1% increase in the share of the young).
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- The authors are careful about the composition of the share of the young population: they use different variables (male white, total white and all young).
- Why not use the male white with no college degree (to keep the same composition over time and focus on the most credit-constrained) ?
- Your regression model assumes that wealth inequality in each state is constant over time. But, as already mentioned, wealth inequality tends to have large effects on fiscal multipliers and, over the period 1967-2015, inequality has increased a lot with some variability across states. A measure of wealth inequality could be added as an explanatory variable ?
- There is a break in the GDP series by US States in 1997. Not a problem ?

- Objective: replicate in a rich model the estimated demographic effect of fiscal multipliers and quantify the sources of this effect.
- Proposed sources: credit constraint, age-dependent Frisch elasticity of labor supply and incomplete bond market.
- Model: two countries, monetary union, one federal government (issues bonds and levies lump-sum taxes), one single bond market, imperfect competition, nominal rigidities, labor and capital immobility.



- In the regression analysis, the average local output fiscal multiplier was 1.51. The calibrated model delivers a multiplier equal to 1.4.
- In the regression analysis, the demographic effect on the local output fiscal multiplier was equal to 3.1%. In the model, it is 1.9%.
- What are the contributions to each of the three potential channels ?
  - If the elasticity of labor supply is identical across ages, the multiplier goes down from 1.9% to 1.6%.
  - If the elasticity of labor supply is identical and only 40% of the young are credit-constrained, the multiplier goes down from 1.9% to 1.4%.
  - If the elasticity of labor supply is identical and there is no borrowing constraint, the multiplier goes down from 1.9% to 0.8% (incomplete market channel).

- I don't see much the value added of the calibrated model with respect to the empirical part.
- I find interesting to have three potential channels for demographics to affect fiscal multipliers.
- I find interesting the attempt to replicate the size of the demographic effect on the fiscal multiplier.
- However, I am less convinced by the quantification of the channels. Doesn't it depend too much on the calibration values ? Is there any policy implications of this quantification ?