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The effects of fiscal policy on the Spanish economy: Keynesian or non-Keynesian behavior?

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Abstract

Can fiscal policy help to the ending of the economic crisis affecting Spain? Given this starting point, we study the effects on the Spanish economy of a shock to total public receipts or a shock to total public expenditure. With that objective in mind, we specify and estimate a vector error correction model with exogenous variables, using quarterly monetary and fiscal data for the Spanish economy from 1978 to 2009.

The results of our simulations show that the effects of shocks to Spanish total government receipts and total government expenditure on real variables are permanent, while their effects on nominal variables are temporary. The response of the Spanish real GDP to a positive shock to total government receipts is positive. In contrast, the response of the Spanish real GDP to a positive shock to total government expenditure is positive in the short run, but negative in the medium to long run. Consequently, these results suggest the existence of non-Keynesian effects related to a disturbance on public receipts and the presence of short-run Keynesian effects related to a disturbance on public expenditure. Both facts must be taken into account when formulating appropriated economic policy measures.
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1. Introduction

The effects of international financial and economic crisis, whose beginning dated back to the bankruptcy of Lehman Brothers (one of the largest global financial services firms) in September

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2008, and the bursting of the Spanish housing bubble, whose climax was marked by the collapse of Martinsa–Fadesa (the country's leading real estate company) in July 2008, have not diluted yet in Spain. The shocking socioeconomic consequences of both facts have spurred the debate on how fiscal policy can contribute to the recovery among the academia, the media and the general public. As a result, the research on the macroeconomic effects of fiscal policy in general, and the benefits and costs of fiscal adjustments in particular, has considerably increased.

At the height of the crisis, the authorities of advanced countries, including the Government of Spain, raised several possibilities to increase aggregate demand based on the recommendations of the available empirical evidence. One of the most unanimous responses was to implement a combined fiscal stimulus package, which contained productive public spending increases, targeted tax cuts or specific transfers to households and firms (Spilimbergo, Symansky, Blanchard, & Cottarelli, 2008). In Spain, some of the most notable measures taken in this regard were the enactment of the Spanish Economy and Employment Stimulation Plan (the State Fund for Local Investment and the Special Fund for Employment and Economic Reactivation), known as "Plan E", or the Sustainable Economy Plan (the State Fund for Employment and Local Sustainability).

Leaving aside the ongoing debate on the sustainability of social security systems in Western economies, those initial measures have originated a situation of generalized deterioration in government accounts, and so the failure to meet the Stability and Growth Pact (SGP) rules in many Economic and Monetary Union (EMU) countries. In order to improve economic growth prospects, the Member States of the European Union (EU) have approved profound reforms in public expenditure and public receipts policies, have also initiated intense fiscal consolidation processes, and even some of them have implemented structural reforms. Nevertheless, low inflation and anemic growth rates and tremendous social sacrifices threaten the economic policy efforts that have been made in the EU countries (see Trichet, 2013; Feldstein, 2015, for a detailed explanation on EMU's configuration and problems).

In light of these developments, it is still premature to accurately and objectively assess the consequences of such measures, but it seems appropriate to reevaluate the lessons from the past. Although much of the literature on the effects of fiscal policy has been based on simulation results obtained from medium and large scale macroeconometric models, the use of vector autoregressive models (VAR) has become the basic tool for this type of empirical analysis in recent years, because of their flexibility and their lower cost of implementation. So, in this paper we use the latter type of models for analyzing the effectiveness of fiscal policy in Spain.

The purpose of this research is to study the effects on the Spanish economy of a shock to the own country's total public receipts or a shock to the own country's total public expenditure and to develop some implications for current economic policy on the basis of the obtained pre-crisis findings. With that objective in mind, we specify and estimate a vector error correction model with exogenous variables (VECMX*) for the Spanish economy, using quarterly macroeconomic, monetary and fiscal data from the second quarter of 1978 to the fourth quarter of 2009.

Despite the fact that we construct a long-run structural cointegrating VAR model following the methodology presented in Garratt, Lee, Pesaran, and Shin (2006), this paper contributes to the literature by several ways: unlike previous work, in our research (1) we focus on the performance of the Spanish economy in the context of the European Union and the United States, (2) we include not only macroeconomic and monetary variables, but also fiscal variables (total government receipts and total government expenditure), and (3) we design our Spanish VECMX* model as an enhanced part of our Global VAR model (Ricci-Risquete & Ramajo-Hernández, 2015) by identifying a set of cointegrating relationships. In order to avoid the distortionary effects that the

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