Accepted Manuscript

Public debt and fiscal policy traps

Antoine Camous, Andrew R. Gimber

PII: S0165-1889(18)30078-2
DOI: 10.1016/j.jedc.2018.02.009
Reference: DYNCON 3563

To appear in: *Journal of Economic Dynamics & Control*

Received date: 7 February 2018
Accepted date: 12 February 2018

Please cite this article as: Antoine Camous, Andrew R. Gimber, Public debt and fiscal policy traps, *Journal of Economic Dynamics & Control* (2018), doi: 10.1016/j.jedc.2018.02.009

This is a PDF file of an unedited manuscript that has been accepted for publication. As a service to our customers we are providing this early version of the manuscript. The manuscript will undergo copyediting, typesetting, and review of the resulting proof before it is published in its final form. Please note that during the production process errors may be discovered which could affect the content, and all legal disclaimers that apply to the journal pertain.

ACCEPTED MANUSCRIPT

Public debt and fiscal policy traps☆

Antoine Camous[a], Andrew R. Gimber[b,*]

[a]*University of Mannheim, Department of Economics, L7, 3–5, 68131 Mannheim, Germany*
[b]*Bank of England, Threadneedle Street, London, EC2R 8AH, United Kingdom*

Abstract

We present a theory linking the cyclicality of tax policy to inherited public debt. When debt is low, tax policy is countercyclical, in the sense that the government responds to low output by setting a low tax rate. Above a threshold level of debt, however, optimal tax policy becomes procyclical. This creates the possibility of self-fulfilling crises ("fiscal policy traps"), in which output is low because households expect high taxes, and the government sets high taxes because output is low. Our model suggests why highly indebted governments might implement procyclical tax policy even without facing high sovereign risk premia.

Keywords: Public debt, Tax policy cyclicality, Coordination failures, Expectation traps, Laffer curve
JEL: E62, H63

1. Introduction

Public debt to GDP ratios in advanced economies have been rising since the mid-1970s, and have recently reached levels not seen since just after World War II (Abbas et al., 2011). The recent financial crisis and the ensuing Great Recession exacerbated this trend through bailouts, stimulus packages, rising unemployment claims, and falling tax revenues. This has led to a heated debate over the pace of fiscal consolidation, with one side emphasizing the burden on

☆This is a revised version of "Public debt and the cyclicality of fiscal policy", which appeared as a chapter in our PhD theses at the European University Institute. We thank Yan Bai, Marco Bernardini, Russell Cooper, Alexander Guembel, Piero Gottardi, Stylianos Sakkas, participants at the European University Institute Macro Working Group, the 20th Spring Meeting of Young Economists, the 47th Money, Macro and Finance Research Group Annual Conference and the 21st Annual International Conference on Macroeconomic Analysis and International Finance, three anonymous referees and the editors for helpful comments and suggestions. The views expressed in this paper are those of the authors, and not necessarily those of the Bank of England or its committees.

*Corresponding author.
Email addresses: camous@uni-mannheim.de (Antoine Camous),
andrew.gimber@bankofengland.co.uk (Andrew R. Gimber)

Download English Version:

https://daneshyari.com/en/article/7358467

Download Persian Version:

https://daneshyari.com/article/7358467

Daneshyari.com