Fiscal Resiliency in a Deeply Uncertain World

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Links with the economics literature

- Paper is about more the fiscal resiliency, but macroeconomic stability and programmatic resiliency in a deeply uncertain world
- Underlying point of departure is a perspective on risk and uncertainty that is markedly different from that prevailing in much of recent macroeconomics—where macroeconomics is about adjustment in a world with rational expectations to a set of shocks with given probability distribution
  - Major shocks (2008, covid-19, new era of protectionism) are almost always outside such a framework

Alternative framework provided in Guzman and Stiglitz, "Towards a Dynamic Disequilibrium Theory with Noise," NBER Woking Paper No. 27453, June, 2020. Earlier decision-theoretic foundations provided, e.g. by Kreps (1979) "A Representation Theorem of "Preference for Flexibility"" *Econometrica;* 1992 "Static Choice in the Presence of Unforeseen Contingencies…"

Still…we know something

- Top down anchors not just arbitrary, are likely to be broken
  - Knowledge that that is the case reduces even their value as a commitment device
  - And even were they not broken, don’t serve the economy well
    - Induce unnecessary contraction
    - Standard anchors are like incomplete contracts
- Design of the policy framework matters
  - Absence of a complete set of AD markets, incomplete contracts, imperfect and asymmetric information means that the market often does not handle risks well—can amplify risk and macroeconomic variability, at great cost to individuals and the macroeconomy
  - Design of system can affect exposure to and management of risks
  - Abrupt, discrete changes are typically far more costly than more gradual adjustments

Things we know we some confidence

- In almost all economic downturns, we would have been better served with better automatic stabilizers and weaker automatic destabilizers
  - Should have been willing to pay something (an “insurance premium”) for greater stability
  - Good arguments for why programs like UI should depend on the state of the economy
- Once we reach full employment, we have to face constraints of resource scarcity
  - But great uncertainty about when these constraints set in and about potential for using existing resources better to move that constraint out

Moment for re-emphasis on fiscal policy

- We've seen limits on monetary policy—and with projected low interest rates for an extended period, monetary policy not likely to play major role in stabilization
  - Limits go beyond zero lower bound—difficulties in inducing banks to lend in a downturn
  - Monetary policy is distortionary—puts burden of adjustment on interest sensitive sector
- Experience over past decade has shown that fiscal policy can be timely and effective
  - Ricardian equivalence had long been discredited
  - Fiscal multipliers can be quite large

Deep uncertainty means that discretion is necessary

- Can’t just leave economy on some kind of auto-pilot
- Behavioral economics tells us that we frequently look for heuristics to help in decision-making
- This is all the more so in contexts of social decision making.
- In a world with deep uncertainty, we can’t simply extrapolate from the past. But neither do we want to “renegotiate” as it were *ab initio* every time we confront a social decision.
- We have provided a framework that allows for efficiency and economy in decision making