Research Seminar "Quantitative Economics"

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Abstract

Debt and Deficits: Fiscal Analysis with Stationary Ratios
(Can Gao)

Abstract
We introduce a new measure of a government's fiscal position that exploits cointegrating relationships among fiscal variables and output. The measure is a loglinear combination of tax revenue, government spending and the market value of government debt that—unlike the debt-GDP ratio—is stationary in the US and the UK since World War II. Fiscal deterioration forecasts a long-run decline in spending rather than increased tax revenue or low returns for bondholders. Fiscal adjustment to tax and spending shocks occurs through mean-reversion in tax and spending growth, with a negligible contribution from debt returns.