





	Model Structure
Mc	ONETARY POLICY AND FISCAL POLICY
	Representative consumer will be "in the background," not the focus, of analysis in Chapter 15 No explicit utility maximization problems, etc.
	But we know where optimal choices of $c_t$ and $w_t P_t$ etc. come if off
	Focus will just be on government actions
	An infinite-period framework
	Two distinct "sides" of the government
	Fiscal authority – i.e., Congress/Treasury
	$\Box  \text{Controls government spending } g_t$
	Collects taxes $T_t$ (will assume only lump-sum taxes throughout)
	Issues (sells) new bonds (for various financing needs)
lance sheet	Receives "profits" from central bank (because it legally charters c.b.)
kage	Monetary authority (aka central bank) – i.e., Fed
d monetary	y by opgaging in open market operations
licy	<ul> <li>Turns over any "profits" it earns to fiscal authority</li> </ul>
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Ac	TIVE VS. PASSIVE POLICY	
	<ul> <li><u>Definition</u>: A policy authority is <u>active</u> if <u>every instrument</u> at its disposal can be completely freely chosen, without any concern for the consolidated government budget constraint</li> <li>Active authority does not engage in policy in such a way as to make sure the consolidated government budget balances</li> </ul>	
	<ul> <li><u>Definition</u>: A policy authority is passive if <u>not every instrument</u> at its disposal can be completely freely chosen, without any concern for the consolidated government budget constraint</li> <li>Passive authority must engage in policy in such a way as to make sure the consolidated government budget balances</li> </ul>	
	$P_t g_t + B_{t-1} = T_t + P_t^b B_t + M_t - M_{t-1}$	
	At beginning of period $t_i$ , $B_{t-1}$ and $M_{t-1}$ are fixed (assume no default	
	Fiscal authority sets $g_{t_i}$ $B_{t_i}$ and $T_t$ Question: How will <u>"consistency"</u> between them be guaranteed?	
	Monetary authority sets $M_t$ Two possibilities	



Ac	TIVE FISCAL/PASSIVE MONETARY	Y POLICY
	Suppose fiscal authority sets all of its policy in of them) with no concern for the consolidated Fiscal authority is active	nstruments (all <u>thre</u> flow GBC
	Monetary authority must <u>react</u> by setting $M_t$ to consolidated GBC holds	ensure the
	Monetary authority is passive	
	Game-theoretic undertones	
	Fiscal authority is the "dominant" policy-maker	
	Fiscal authority is the "leader"	
	Monetary authority is the "lagging" policy-make	er
	Monetary authority is the "follower"	
	Policy pressure (by fiscal authority on moneta implicit and (largely) through market forces	ry authority) is
	U.S. Fed is independent of Congress	
	But in developing countries?	







	Short-Run Interactions
Ac	TIVE VS. PASSIVE POLICY
	<ul> <li>Which regime describes the U.S.?</li> <li>Matter of a lot of debate</li> <li>Maybe there's "regime switching" – i.e., each authority "takes turns" being the follower and the leader</li> <li>Through the rise and fall of political power?</li> <li>Through the ascendancy of strong central bankers?</li> </ul>
	Game theory a compelling way to study monetary-fiscal interactions (more advanced course)
	Core issue: there are <i>limits</i> or <i>restrictions</i> that each policy-setting authority places on the actions of the others
	Analysis so far: the period- $t$ choices of one policy authority restrict the choices of the other policy authority in period $t$
XT ME	A more realistic view: the period- <i>t</i> choices of one policy authority may restrict the choices of the other policy authority in period <i>t</i> and/or period $t+1$ and/or period $t+2$ and/or period $t+3$ ,
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