Fiscal Policy and the Current Account

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Notes

1. The paper primarily analyzes association between changes in overall fiscal policy and the current account for an individual country. It does not delve into questions about the global transmission of fiscal policy shocks.

2. The marginal rate of substitution between the home and foreign country private consumption must be mirrored by the real exchange rate. Thus, a rise in current home private consumption (relative to the rest of the world) implies a real depreciation of the home currency.

current account); the lag of per capita PPP GDP (to control for current account movements related to income convergence); year dummies (to control for common shocks across countries); and fixed country effects (as Hausman test did not support random effects). In regressions 3–7, noninteracted dummies were included to allow for heterogeneous intercepts. The results are almost identical with GMM (system) methods that address the estimation bias arising from the inclusion of the lagged dependent variable. Robustness to outliers was ensured by dropping all observations where either the absolute value of the current account ratio or the CAPB ratio was above 20 percentage points.

7. An alternative interpretation could be in times of economic crisis, private consumption collapses much more than government consumption, which translates into a stronger current account, while the fiscal balances deteriorate.

Appendix III available on the journal website.

12. In the results presented in the paper we include the output gap when using quarterly data and the log of the real GDP when using annual data. We have also run a specification for quarterly data using real GDP. But with shorter time series our estimates were affected by the nonstationarity of the output series. Although the results were qualitatively similar over the first quarters, the responses were in many cases explosive after 5 or 10 quarters.

13. The standard mean-differencing method to remove fixed effects would bias coefficient because of the correlation between lagged dependent variable regressors and fixed effects, The Helmert transformation avoids this problem by using forward mean-differencing.

react to output within a year? Corsetti, Meier, and Müller (2010) discuss this issue in detail and, while it might be that during the 2008–09 crisis governments reacted quickly to economic conditions (maybe as fast as 5 to 8 months), this is more of the exception than the norm. Indeed, budgets are done on an annual basis and changes during the fiscal year are more cumbersome. In fact, the evidence from VARs that use quarterly data show that in response to output shocks the response of government consumption is small and insignificant over the first quarters (in most cases it remains insignificant at any horizon). In addition, Corsetti, Meier, and Müller (2010) also justify the use of annual data on the grounds that spending shocks might be foreseeable.

19. If we exclude the oil exporters (not shown in the figure), in response to a 1 percentage point of GDP increase in government consumption, the current

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Supplementary Appendices

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