Reconciling the Effects of Government Spending: The Role of Information Frictions
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**Motivation**
- Recent large fiscal stimulus (GFC, Covid-19) -- greater effort to understand the variations of how government spending influences the business cycle.
- Fiscal policy theoretical and empirical "mismatch" (Leeper, Traun & Walker, AER 2017)
- Information frictions matter for macroeconomic policymaking

**Research Question:** Do information frictions affect the transmission of government spending shocks? Yes.
- This paper documents a novel result that reconciles the Keynesian and neoclassical predictions of fiscal policy by emphasizing the importance of information frictions.
- Empirical: non-linear local projections framework with forecasters' disagreement as a measure of information frictions.
- Theoretical: quantitative framework to explain the empirical findings on how information frictions could affect the consumption response to a government spending shock.

**Empirical Methodology**
Local Projections Structure

\[ x_{t+h} = \alpha_t + \beta_{t+h} x_{t+h-1} + \gamma_{t+h} (L) x_{t+h-1} + \delta_{t+h} \text{shock} + \epsilon_{t+h} \]

- Follows Flannery and Zalyubiy (2018 JPE)
- lag: high information frictions: 3 – 3 urban disagreement shown median
- \( \epsilon \): control variables (lags of government spending and x)

**Disagreement as a Proxy for Information Frictions**
- There is a lot of disagreement in survey data, even on current conditions
- Time variation in disagreement driven by information frictions
- Agents not fully informed at the time → Heterogeneity in beliefs changes over time
- Consistent with information frictions predictions (Andrade et al., JME 2016)
  - Sticky information: slow diffusion of information (Mankiw, Reis and Wolthers, 2004)
  - Rational inattention: optimal attention allocation (Sims, 2003)

**Disagreement Series**: SPF Real GDP (1970-2018)
- Real GDP Nowcast Dispersion
- Threshold: median disagreement
- Red shaded: high disagreement periods
- Grey shaded: NBER-dated recessions

**Fit in the Literature**
- Empirical
- Theoretical

**Fiscal Policy**

**More Results in the Paper**
- Empirical results: response of various macroeconomic variables to disaggregated shocks
- Empirical robustness checks: placebo tests (time periods as threshold), alternative measurements of disagreement
- Quantitative framework results: Impulse response functions and value of information gain relative to other variables, impact multipliers with varying degree of information frictions
- Policy implications: Economic agents pay attention and respond differently to different fiscal shocks. Fiscal policymakers need to understand this decision making process of firms and households.

**Key Findings**
Reconciling predictions on the effects of government spending
- IFIs to 1% government spending shock
- IFIs to 1% government spending shock
- IFIs to 1 dollar shock
- Observations: government spending, government investment, Transfer Payments
- Intuition for Response of Consumption to a Government Spending Shock
- Sticky Information General Equilibrium Model
- Household and Asset Market Participants
- Aggregate

**Impulse Responses with Varying Degree of Inattentiveness**
- Ricardian Lifetime Consumption
- Balance-of-Thirsk Lifetime Consumption

**Table**
- Holiday households
- Limited Asset Market Participants
- Aggregate