Discussion: High-Frequency Identification of Defense News Shocks

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How much does government/defense spending affect aggregate outcomes?

Context:

- Still unsettled how much output, inflation, etc. responds to changes in government spending
- Different approaches, different drawbacks, different estimates
- Exogenous changes in defense spending often used as variation

Empirical challenge:

- Policymakers don't randomly allocate spending; issue of endogeneity
- Anticipation effect
- State dependence
- Method of financing: Through taxes, debt issuance, or monetization?

This paper

Use excess return of defense contractor stocks in windows around policy announcements as an instrument for
instrumental-variables local-projection estimation

- Significant fiscal multipliers over short run: > 2 for 12 first quarters
- Reversal over longer run: ≈ 1.5 after 20 quarters
- Quantifies roles of the state of economy and monetary policy in amplifying/weakening effect

Identification using an IV approach

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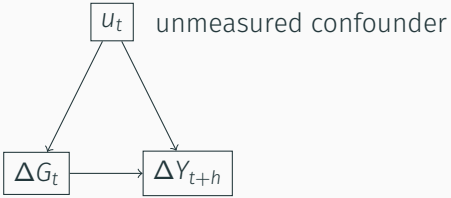

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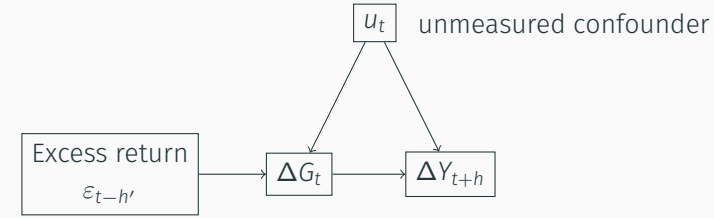

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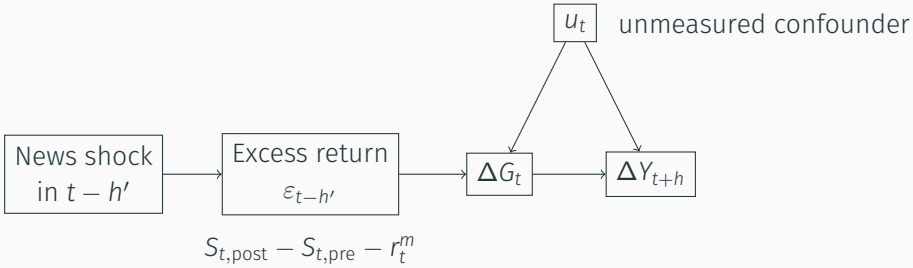

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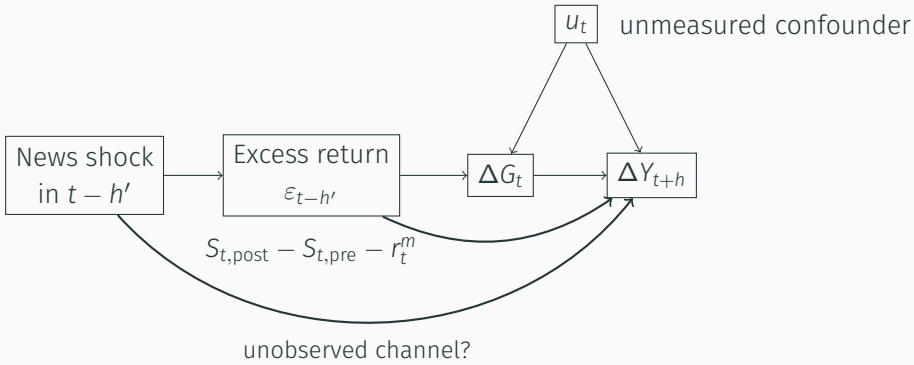

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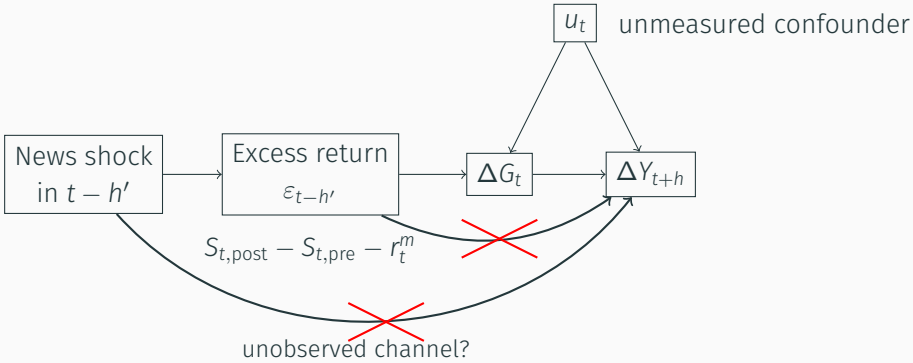

Exclusion restriction

Key assumption:

$\varepsilon_{t-h'}$ captures only features of the News shock that affects ΔG_t's influence on output Y_{t+h}

Requires assumptions about SDFs, costs, and markups – which are testable

Defense contractor's stock price S_t:

$$S_t = \mathbb{E}\left[\sum_{\tau \geq 1}^{n} \Lambda_{t+\tau}\, \text{div}_{t+\tau} + \Lambda_{t+n}\, S_{t+n} \mid \mathcal{F}_t\right], \quad \forall n \geq 1 \tag{1}$$

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  Should also be available in public reports

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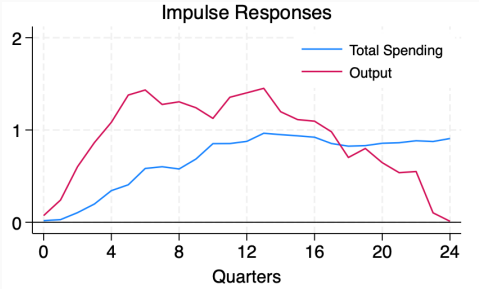
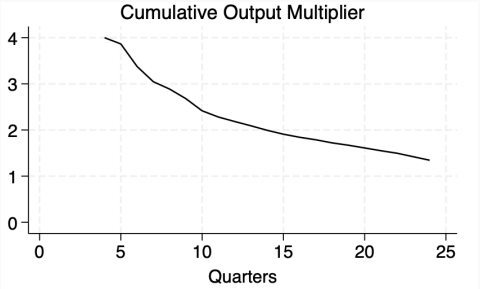
But! Even if not, then think about how estimates will be biased. Up? Down? is the measured multiplier a lower or upper limit?

The fast response of output





The drivers of the early big rise in output is important

- Is it consumption or investment?
- *Whose* consumption or investment?
  - Regional data
  - Financial data (defense contractor investment and hiring)

Other comments i

- Defense production is about 20% of spending – where is the rest going? Can you pick up on that?
- Addressing the external validity questions could be something that goes beyond previous work and validates the method
- Is it possible to say anything about agents expectations of future inflation or taxes to cover spending? That affects decision making too
- Does taking out r_t^m remove some expected GE effects, and does that affect multiplier?
- You say other methods lack power (e.g., post Korean War). Can you say what about your/their method is key to get around this?

Other comments ii

- Discussion on the accuracy of longer-run effects? What multiplier do we end up with believing in the most?
- I agree that the spending seems to be tax-financed in short run, but it seems like it is debt-financed in the long-run
- Do your defense spending multiplier generalize to overall government spending multipliers? Why? Why not?

Conclusions

BIG important question

Requires careful, technical implementation
Which is well executed and presented

Fiscal multiplier is dynamic, but steadily above 1