Making government paper a bad investment

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Outline

- Why FTPL is central in analyzing and exiting the ZLB
- Why it's difficult to apply
  - Most of the literature assumes RE, commitment, fixed, understood policy rules.
  - History is not available to discipline the public's expectations about policy at the ZLB
- Can a theory reliant on *transversality conditions* be relevant to actual behavior?

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- How do we get to this situation? Government paper becomes too attractive relative to private sector real assets. Figuring out how to make government paper less attractive is the central to policy at the ZLB.

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- One can write an entirely backward looking model in which the price level is uniquely defined and stable under active fiscal / passive money.

- The instability the GBC might generate is damped by the appearance of government debt as a wealth effect in the consumption function.

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- I don't have a unique answer.
- Learning and bounded rationality are surely relevant.
- However existing frameworks of this type seem to me too narrow.
- Sometimes, government policy announcements of commitments work amazingly well. (Inflation targeting in some countries; Jalil/Rua and Jacobson/Leeper/Preston, analysis of an inflationist policy episode in the thirties.)

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- A Gallup poll a few years ago showed most Americans not yet collecting social security believing that social security would no longer exist when they retired.

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- For example: Coordinating fiscal and monetary policy so that *both* are explicitly contingent on reaching an inflation target — not only interest rates low, but no tax increases or spending cuts until inflation rises.
- This might work because it would represent such a shift in political economy that people would rethink their inflation expectations.

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- In Europe, the barrier is the lack of any Euro-wide fiscal institutions.
- These changes are not going to happen soon.
- But spreading academic understanding of the need for such changes, supported by research like that we are discussing here, might eventually help us move in that direction.

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