Introduction to the INFER-2018 Special Issue on Applied Macroeconomic Policies in Open Economies

Pedro Cerqueira[1], Alexia Gaudeul[2], Inmaculada Martínez-Zarzoso[2,3] and Stephan Mueller[2]

Abstract

This editorial provides an overview of recent empirical contributions to macroeconomic policies in open economies, with a focus on European and small emerging countries. It introduces a special issue composed of a selection of articles presented during the 20th Annual Conference of the International Network For Economic Research (INFER). The conference took place at the University of Goettingen in September 2018. The articles included in this special section discuss fiscal and monetary policy effects and continues covering labor market issues and the determinant and effects of international transfers for specific countries. Finally, a methodological paper that presents an improved technique for time series analysis closes the issue.

Keywords: fiscal multipliers, fiscal policy, stock market efficiency, corporate bonds, labor market, remittances, FDI, local polinomial regression

1. Introduction

This special issue contains a selection of empirical papers presented at the annual INFER-2018 Conference held at the University of Goettigen in September 4-5th, 2018. The conference serves as the annual plenary meeting of the network. INFER is an international network whose main objective is to promote research in economics that makes use of rigorous theoretical and empirical modeling strategies to address current socio-economic challenges.

The themes of the selected papers evolve around macroeconomic policies in open economies, with a focus on European and small emerging countries. The special issue starts with research on the effects of fiscal and monetary policies and continues with labor market issues and the determinants and effects of international transfers for specific countries. Finally, a methodological paper that presents an improved technique for time series analysis closes the issue.

2. Overview of the Special Issue papers

The challenge in estimating the fiscal multipliers across European Union countries is addressed in the article written by Nicolae-Bogdan Ianc and Camelia Turcu entitled: *"So alike, yet so different: comparing fiscal multipliers across EU members and candidates".* The authors estimate fiscal multipliers by applying a panel vector autoregressive (PVAR) model to four different country groups using real output, real government spending and taxes over the time span 2003-2015. The first group is composed of founding EMU countries; the second of central and eastern European countries that are members of the EMU; the third contains EU countries

[1] University of Coimbra, CeBER, Faculty of Economics, Av Dias da Silva 165, 3004-512 Coimbra, Portugal.
[2] University of Goettingen, Faculty of Business and Economics, Goettingen, Germany.
[3] University Jaume I, Department of Economics, Castelló, Spain.

that are not part of EMU and the fourth includes EU candidates. The authors find that the spending multiplier is different in the short and long run across groups. In particular, EU candidates have the highest short run spending multipliers, but in the long run the EMU candidates have a positive spending multiplier while that of EMU countries is negative. The tax multipliers are similar across all groups in the short run, but show opposite signs in the long run, being positive in EMU countries and negative among EU candidates. This reflects better tax collection in the EMU countries.

The semi-strong market efficiency hypothesis with respect to fiscal policy information in the context of the Bucharest Stock Exchange is the object of the paper: *"Fiscal Policy and Stock Market Efficiency: An ARDL Bounds Testing Approach"* authored by Andreea Stoian and Filip Iorgulescu. To overcome data problems such as inconsistencies and structural breaks, the authors use an Autoregressive Distributed Lag (ARDL) bounds testing approach, which allows them to assess the long and short-term connection between fiscal policy and stock returns. They use quarterly data from 2006 until 2018 for the overall budget balance to GDP and the BSE stock prices from the Bucharest Exchange Trading. Other controls used are the 3-month interest rates on the money market, the consumer price index, the industrial production and the oil price to control for overall macroeconomic factors. The results suggest that, in the long run, stock prices fully and efficiently reflect information on past fiscal policy, while in the short run the stock market reacts efficiently only to unexpected fiscal policy news. In addition, the results show that stock prices do not reflect information on past monetary policy, neither in the short or in the long run, even though the impact of monetary policy on stock prices is larger than that of fiscal policy.

The manuscript entitled *"How much profit shifting do European banks do?"* written by Serena Fatica and Wildemer Daniel Gregori exploits a new dataset based on the country level public recording (CBCR) data to investigate tax-induced income shifting by the biggest and systematically relevant European multinational financial institutions identified by the Financial Stability Board (FSB), the national authorities and the European Bank Authority (EBA). To estimate the share of profit-shifting the authors follow a standard identification strategy that consists in linking variations in tax rates to reported income in multinationals subsidiaries by implementing a production function approach which predicts the level of profit generated if there was no profit-shifting incentives. The simulation results show that there is a substantial level of profit shifting towards tax heavens, as 7% of true profits are shifted to countries that are not tax havens, while 38% is shifted to tax havens.

The next contribution convers monetary issues that are of great importance in the current policy debates. In the 2000s, assets managed by investment funds started to proliferate in developed economies, which raised concerns related to financial stability. The next article entitled "*Do mutual fund flows affect the French corporate bond market?"* by Virginie Coudert and Dilyara Salakhova investigates whether investors' withdrawals from mutual funds affect corporate bond prices in the French market. The expectation is that mutual funds exert downward pressures on asset prices when facing investors' redemptions, given that they have become major players in the financial markets. This is especially so in less liquid markets such as the market for corporate bonds. A novel dataset on French bond funds is used to show that in and out flows by mutual funds have a significant effect on the corporate bond yields. This effect is asymmetric, whereby redemptions induce a greater change in yields than inflows. Moreover, prices are more sensitive to redemptions when the share of the corporate bond owned by funds increases.

Moving to labour market issues, the paper entitled "*The interaction between private sector and public sector labor markets: evidence from Romania*" by Valeriu Nalban and Andra Smadu deals with the spillover effects originating from sectoral labor market shocks in Romania. The authors start by estimating a time series model to recover data-driven evidence and continue by presenting a New Keynesian model, which features public and private sector employees to provide potentially substitutable labor services. In this environment, the government decides on the optimal amount of public employment, public wages and borrowing. The estimated structural model captures the empirical evidence; public job creation crowds out private sector employment and is contractionary, while increases in public wages lead to muted spillover effects. Increases in both private employment and wages, on the other hand, have sizable crowding in effects on public sector employees and are strongly expansionary. These results support the use of active labor market policies that primarily target the development of the private sector.

The next two papers examine important aspects related to international transfers, their determinants and socio-economic effects. The first one entitled "*The impact of remittances on savings, capital and economic growth in small emerging countries*" by Zouhair A. Benhamou and Lesly Cassin uses an overlapping generations (OLG) model in order to capture the economic and demographic effects of remittances in small open economies. Household decisions on education and savings are modeled such that elderly people receive remittances and domestic transfers from their children. Due to a boost in returns from human capital investments as well as higher levels of productivity elsewhere, remittances increase education at the expense of domestic savings. A significant negative correlation is found between domestic savings and remittances in a large set of countries. The model predicts an inverted U-shaped relationship between remittances and economic growth, as explained by the described substitution effect. A counterfactual analysis on five Caribbean islands is conducted, which shows that different strategies regarding domestic transfers and remittances may be successful in fostering growth, depending on the scale of migration and on the transfer rate.

The next paper focuses on the determinants of foreign direct investment (FDI). The paper "*What drives German Foreign Direct Investment? New evidence using Bayesian statistical techniques*" by Mariam Camarero, Laura Montolio and Cecilio Tamarit provides new evidence on the determinants of German FDI using data over the period from 1996 to 2012. A Bayesian model averaging (BMA) approach is used in order to reduce model uncertainty. The main findings indicate that determinants associated with horizontal FDI appear to be best explain FDI in developed countries, while determinants associated with vertical FDI play a larger role in developing ones. A similar pattern is found in Europe, where the majority of FDI is horizontally driven in "core" countries, while vertical motivations seem to prevail in the "periphery". The results are in line with complex FDI models in which vertical determinants and institutional variables are gaining prominence due to the leading role played by Germany in global value chains. The results of this research provide guidance for policymakers' strategies to attract German investment.

Finally, the paper from Marlon Fritz entitled *"Steady State Adjusting Trends Using a Data-Driven Local Polynomial Regression"* proposes a new methodology to detrend economic time series. More precisely, the new detrending methodology uses a data-driven nonparametric trend estimator that is a local polynomial, which improves the arbitrary trend estimations of commonly used methods with respect to the selection of the smoothing parameter and the dependence structure. Moreover, an iterative plug-in algorithm determines the bandwidth endogenously and allows a theory-based interpretation of the length of growth processes. To show the effectiveness of the procedure, the author performs an extensive simulation study and an application to the real GDP of the USA from 1790 to 2015. The results show that the proposed methodology is more efficient than the use of a linear trend, whenever this is not linear. Moreover, it represents an improvement regarding other non-linear detrending methodologies, such as the Hodrick-Prescott filter, which is not consistent and often heavily distorted by the error process.

3. Conclusions

Finally, we would like to mention that this collection of papers represents a small selection of the works presented in the INFER conference, a number of which were submitted to this special issue. All submitted papers were given full consideration and were subjected to a two stage the standard peer review procedure of Economic Modelling. We believe that the selected studies contained in this Special Issue have made significant contributions to the empirical literature on macroeconomic policies in open economies, with a special focus in European and small emerging countries and also raising questions for future research directions.

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