The Size of Fiscal Multipliers and the Stance of Monetary Policy in Developing Economies

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In this paper we estimate the effect of government consumption shocks on GDP using a panel of 21 developing economies. Our goal is to better understand the reasons for the low fiscal multipliers found in the literature by performing estimations for alternative exchange rate regimes, business-cycle phases, and monetary policy stances. In addition, we perform counterfactual simulations to analyze the possible gains from fiscal-monetary policy coordination. The results imply that government consumption shocks are usually followed by monetary policy tightening in developing economies with flexible regimes. Our simulations show that this reaction partially explains the presence of low fiscal multipliers in these economies. Government consumption shocks imply lower multipliers in developing economies during flexible regimes, economic slowdowns or monetary contractions. In addition, implementing fiscal programs during monetary expansions seems to improve significantly their economic stimulus.

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