

Dear Referee 1, thanks for your comments. We would just like to respond to a couple of specific aspects.

(1) On the issue of nominal rigidity and fiscal policy. The issue of nominal rigidity and imperfect competition is indeed important: this is an issue which Dixon has surveyed and discussed elsewhere, in (New Palgrave entry on New Keynesian Macroeconomics and Dixon 1998). However, whilst there is a current and growing literature on Fiscal policy in new neoclassical synthesis models, we felt that this is really a subject for a different survey (on page 2 point (6) we explicitly exclude this from our survey).

(2) From the historical perspective, there was an important and lasting contribution. Prior to these papers, in the standard neoclassical (and indeed new classical) macroeconomic models, the wealth effect on the labour supply had been suppressed: labour supply depended only on the real wage. Hence there was a vertical aggregate supply curve that was independent of the level of lump-sum taxation and government expenditure, and a (long-run) fiscal multiplier of zero. The Dixon-Mankiw-Startz papers introduced the link between expenditure, taxation and the labour supply that has since become a standard feature of fiscal policy analysis in NNS models. This is what you (referee 1) call the neoclassical supply side effect (indeed, Dixon called it *Walrasian*). However, I think you will find that this “neoclassical effect” is not present at all in the neoclassical literature prior to 1990. The first paper to explore it in the RBC setting was Baxter and King (1993). In many previous neoclassical models, the labour supply had been fixed (e.g Barro 1989) and in RBC models fiscal policy (Government expenditure and taxation) was usually omitted or treated as an exogenous shock process (e.g. Kydland and Prescott (1982), Prescott 1986)).

(3) However, the relationship of the literature surveyed to the current debates should be better highlighted. One which I think is important is that changes in imperfect competition over time (for example, due to globalisation) would lead one to expect changes in the effectiveness of fiscal policy.

Barro, (1989): The Neoclassical Approach to Fiscal Policy." In *Modern Business Cycles*, MIT Press, 1989

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Dixon (2007): "New Keynesian macroeconomics: Entry For New Palgrave Dictionary of Economics, 2nd Edition",

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Dixon (1998): The role of imperfect competition in new Keynesian economics, <http://huwdixon.org/SurfingEconomics/chapter4.pdf>

Kydland and Prescott (1982) **Time to Build and Aggregate Fluctuations,** [Econometrica](http://www.nber.org/papers/W0283).

Prescott (1986), Theory ahead of measurement.