

Referee Report on Biagio Bossone Secular Stagnation

The paper analyzes an important and timely issue – the effectiveness of different policy strategies in a situation of secular stagnation. The paper presents an inter-temporal model, characterizing the decision problem of a representative agent. It also introduces some loss function of a central bank and a characterization of government actions. Secular stagnation is modelled as a large and persistent deterioration in “market sentiment.”

Unfortunately, the paper deviates in numerous ways from standard modelling approaches. It is hard to relate the un-usual features in the paper to standard results as in the recent paper by Eggertsson/ Mehrotra. The author needs to convince the reader about the additional value added of his modelling strategy. In the present form, this is not convincingly done. Let me outline some examples for the problems I have with the paper:

The paper allows the representative agent to hold an arbitrary set of assets and introduces some ad-hoc specification for the utility of holding any specific asset Q . Such a procedure seems to be unsatisfactory for the following reason: It seems completely arbitrary what feature might determine the specific pay-off of different types of assets.

In standard micro-founded models, assets do not generate utility but rather are a means for re-allocating inter-temporal resources. The pricing kernel of assets needs to be derived endogenously. In the absence of a complete set of markets, the utility of holding risky assets needs to be motivated by some kind of “indirect” utility out of first principles.

The paper argues that money as perfectly liquid asset has no nominal risk, but it does not model the risk underlying other types of assets. It is not clear how the prices of these risky assets are derived endogenously. Neither is the transmission mechanism of monetary policy well specified.

The central bank’s loss function is completely ad-hoc and not motivated at all.

It seems strange that both in the transversality constraint and in the inter-temporal budget constraint, the authors aggregate income levels and government spending across time without any inter-temporal pricing.