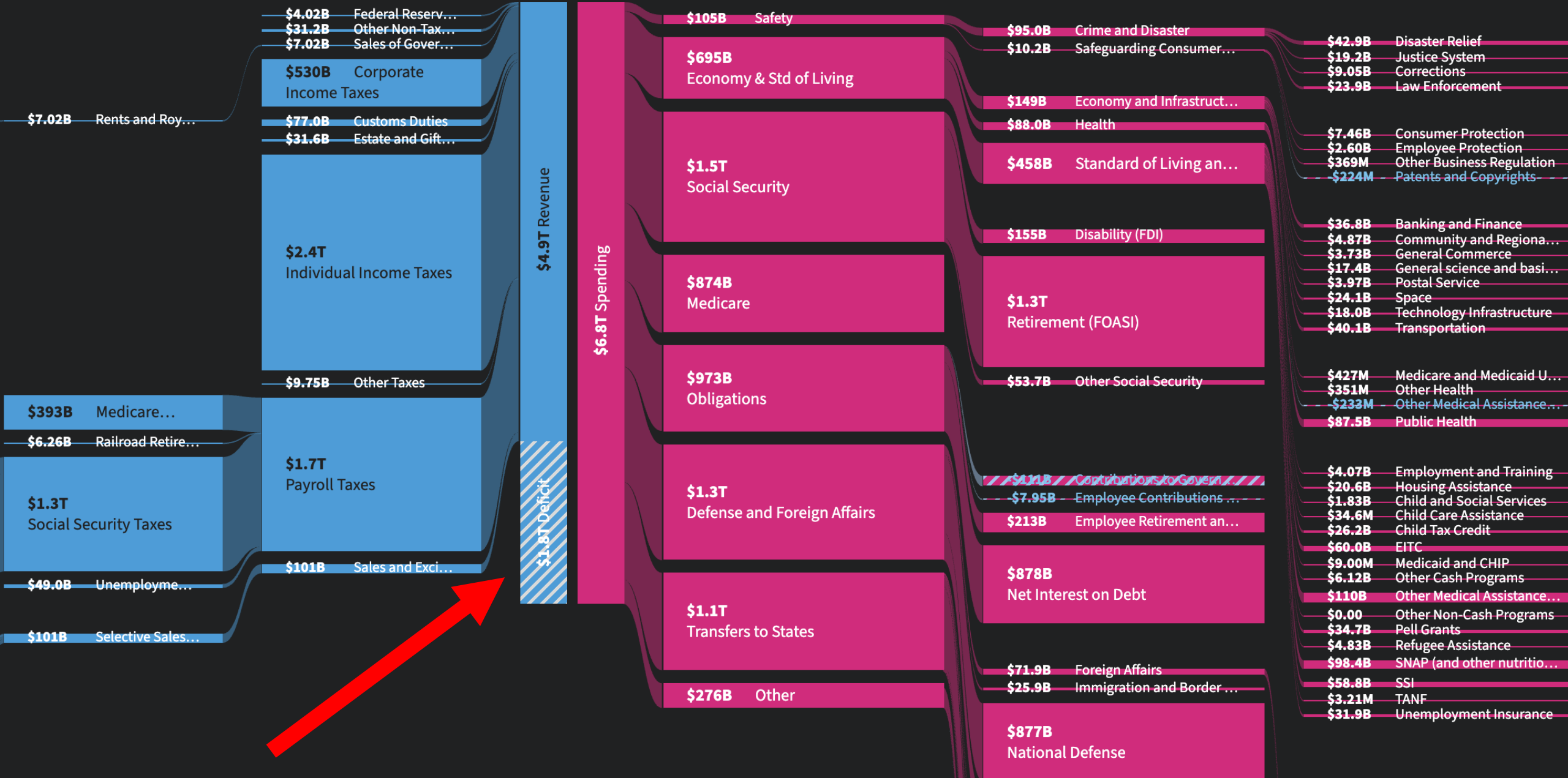


Discussion of
“Fiscal Redistribution Risk in
Treasury Markets”

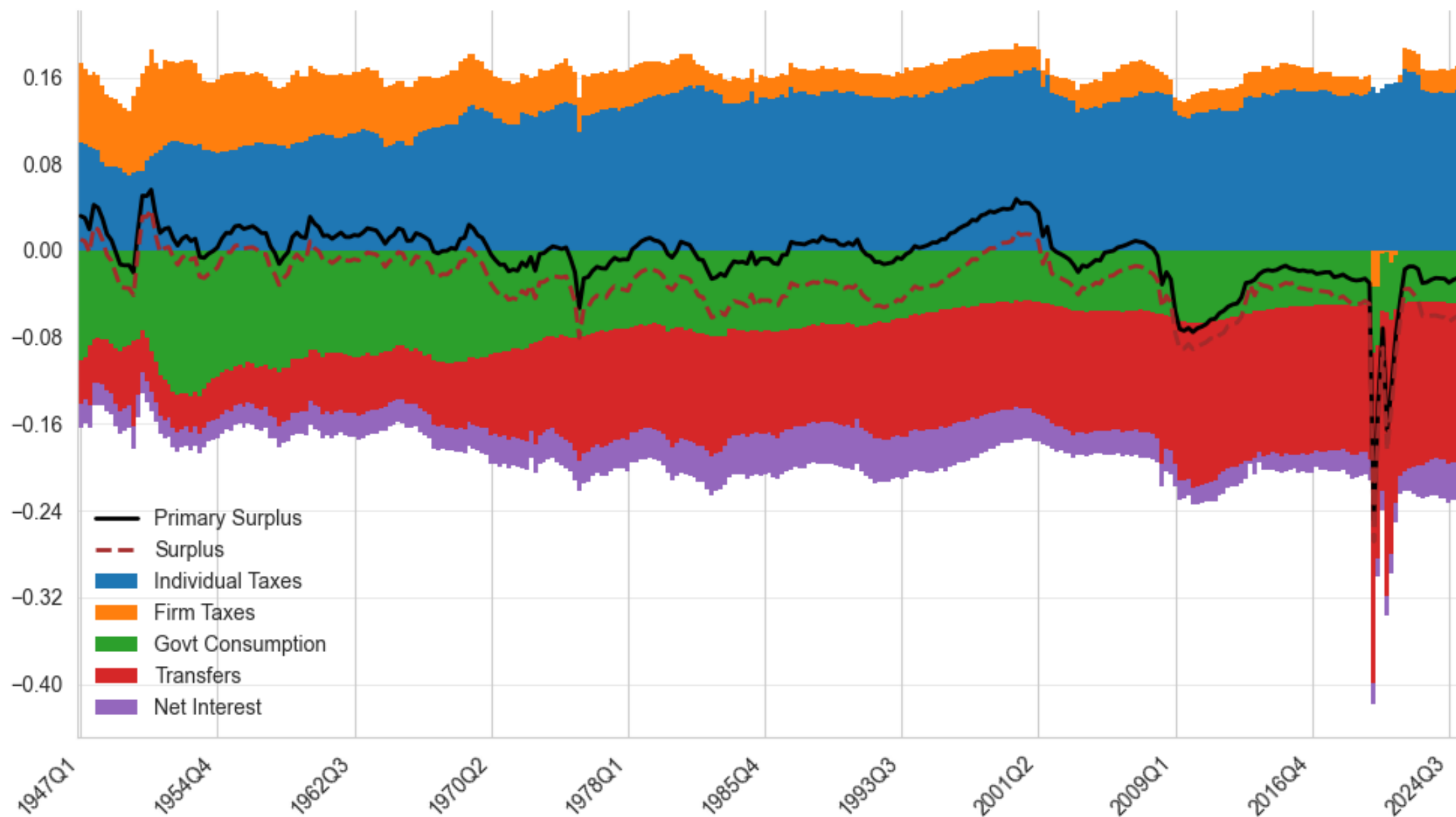
by Roberto Gomez-Cram, Howard Kung, Hanno
Lustig, and David Zeke

Vadim Elenev
Johns Hopkins Carey
Macro Finance Society | November 2025

2024 U.S. Federal Revenue and Spending (Steve Ballmer's usafacts.org)



Federal Fiscal Policy Over Time



Who Finances Government Spending?

Taxpayers

- Not contemporaneously – budgets aren't balanced
- But maybe in the near future?
- Or the far future?

Bondholders

- Bonds are nominal
- Real returns depend on inflation
- Central banks don't **have** to stabilize inflation. They can stabilize government debt instead.

Leeper/Cochrane/Bianchi/others

Taxpayers

- Active Monetary
- Passive Fiscal
- “New Keynesian”
- Taylor Rule
- Taxes increasing in Debt/GDP
- Stable Inflation
- Volatile Debt?

Bondholders

- Passive Monetary
- Active Fiscal
- “Fiscal Theory of the Price Level”
- Taylor Principle Violated
- Taxes flat/decreasing in Debt/GDP
- Volatile Inflation
- Stable Debt?

This Paper: Bond Returns

Monetary Dominance (MD)

- Active Monetary
- Passive Fiscal
- “New Keynesian”
- Taylor Rule
- Taxes increasing in Debt/GDP
- Stable Inflation
- Volatile Debt?
- Low Bond Risk Premia

Fiscal Dominance (FD)

- Passive Monetary
- Active Fiscal
- “Fiscal Theory of the Price Level”
- Taylor Principle Violated
- Taxes flat/decreasing in Debt/GDP
- Volatile Inflation
- Stable Debt?
- High Bond Risk Premia



Taxpayers

Bondholders

Representative Agent Models: No Redistribution

LAMP + FD = Redistribution → Term Risk

- Limited asset market participation (presence of hand-to-mouth HHs)
 - + fiscal dominance
 - = spending redistributes from HHs who hold bonds to those who don't
 - → source of bond risk premia
-
- Finance (this paper): monetary-fiscal policy can explain asset price dynamics
 - Macro (next step?): observed asset price dynamics can identify policy regime
 - Advantage of asset prices: real-time, high frequency, forward-looking, still available when the government is shut down
 - This will be the focus of my discussion

Endowment Economy with Spending Shocks Only

Monetary Dominance → No Redistribution

Spending
(transferred to
HHs per capita)
goes up

No
contemporaneous
response in taxes

HtM HHs
consume more

$C \downarrow$
Asset-holders
consume less to
absorb bonds

But bonds are
claim to future tax
revenues

$PV \uparrow$
Future
consumption goes
up

Wealth
unchanged

Inflation
unchanged,
nominal rate
unchanged

Bond prices
unchanged



Takeaway:

if we see inflation or bond prices respond to spending shocks,
evidence of fiscal dominance (at least partly **unfunded** spending)

Does IES matter?

- Closed-form derivations much simpler with infinite IES

$$1 = \mathbb{E}_t \left[\exp \left((1 - \gamma) \log(\beta) - \gamma r_{At+1} - \pi_{t+1} + i^* + \rho_\pi (\pi_t - \pi^*) \right) \right]$$

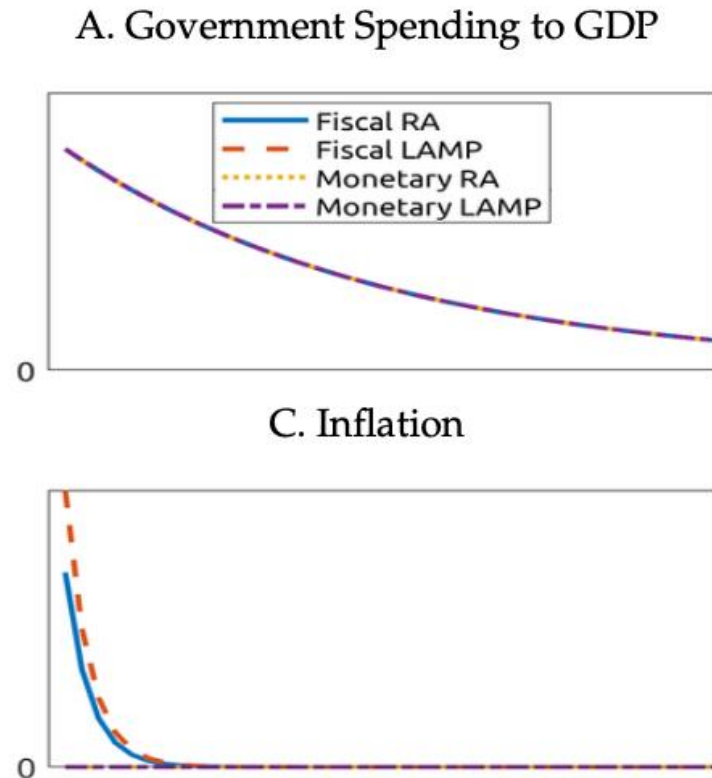
- Clear implication: if return is constant, so is inflation
- No longer the case with finite IES. E.g., CRRA:

$$1 = E_t [\exp(\log(\beta) - \gamma \Delta c_{t+1} - \pi_{t+1} + i^* + \rho_t (\pi_t - \pi^*))]$$

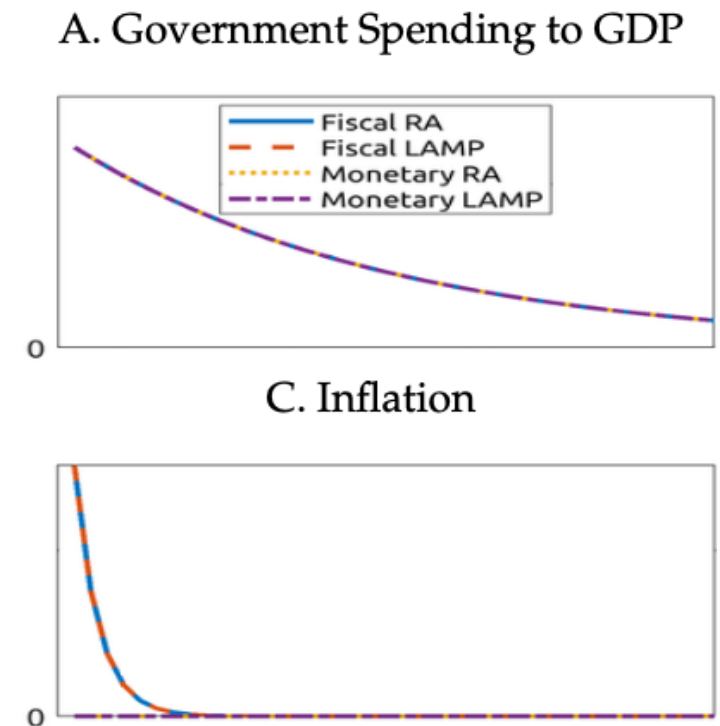
- Drop in asset holder's C must be accommodated through π

Why is inflation flat in monetary case with finite IES?

Infinite IES (Derivations in the Paper)



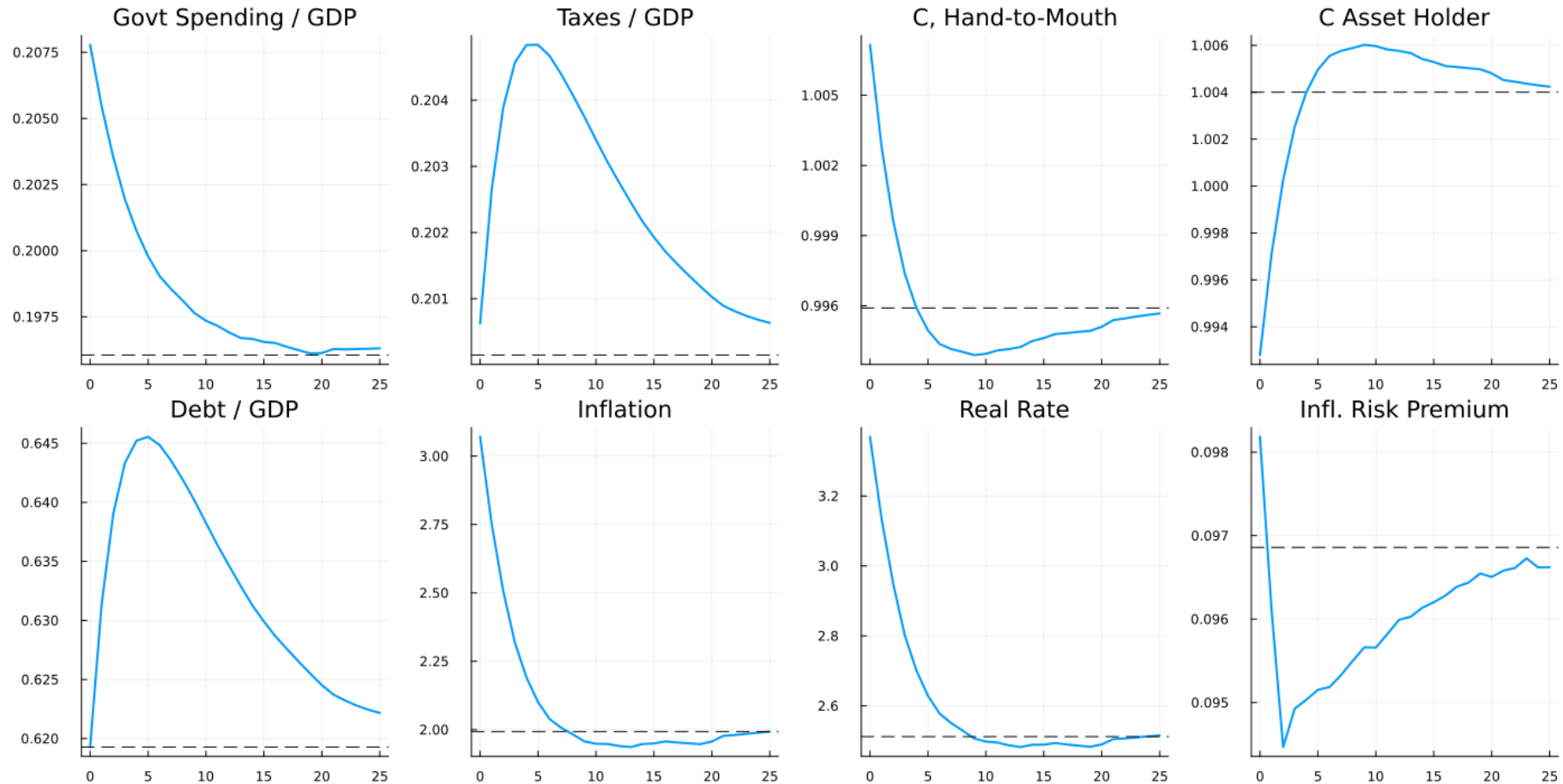
Finite IES (Only IRFs in Appendix)



Why is inflation flat in monetary case with finite IES?

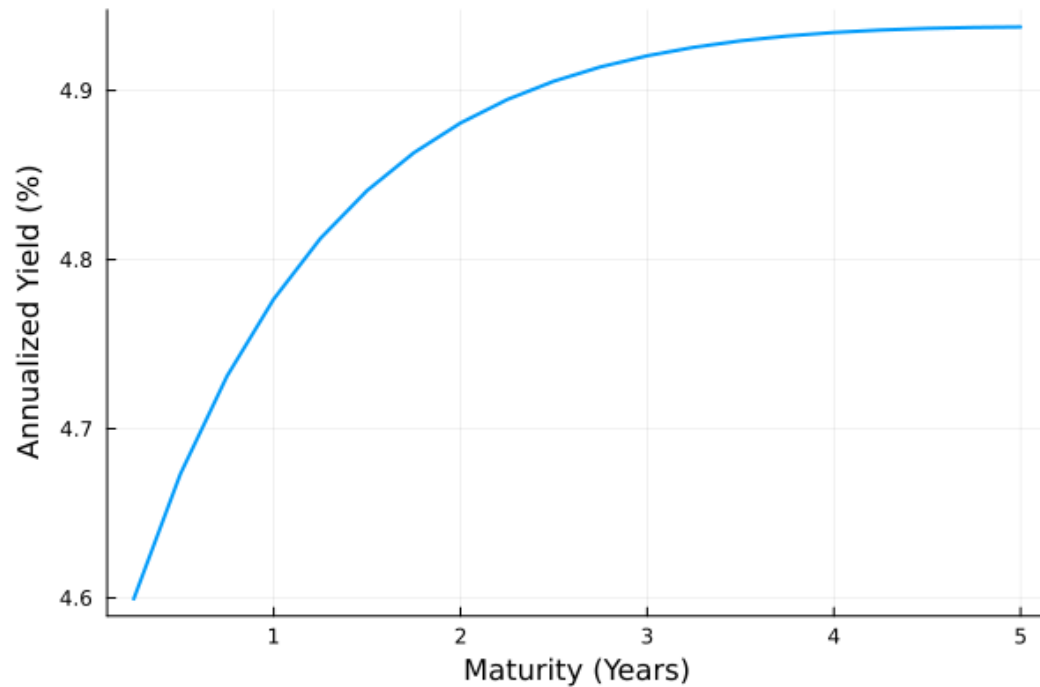
- If it's not, hard to tell regime from impulse responses
- When it comes to solving models, my comparative advantage
 - IS NOT in methods of undetermined coefficients
 - IS in numerical global methods
- Let's
 - Solve the endowment economy globally (paper has a richer quantitative NK model solved with affine approximation but I still want to focus on “pure” spending shock effects)
 - Focus on monetary dominance case
 - Do some comparative statics
 - Use flexibility of global methods to study some interesting extensions
- Happy to share Julia code with authors and anyone else
(NB: needs a tweak to handle $\rho_\pi = 0$ case)

Spending Shocks Inflationary In MD Regime

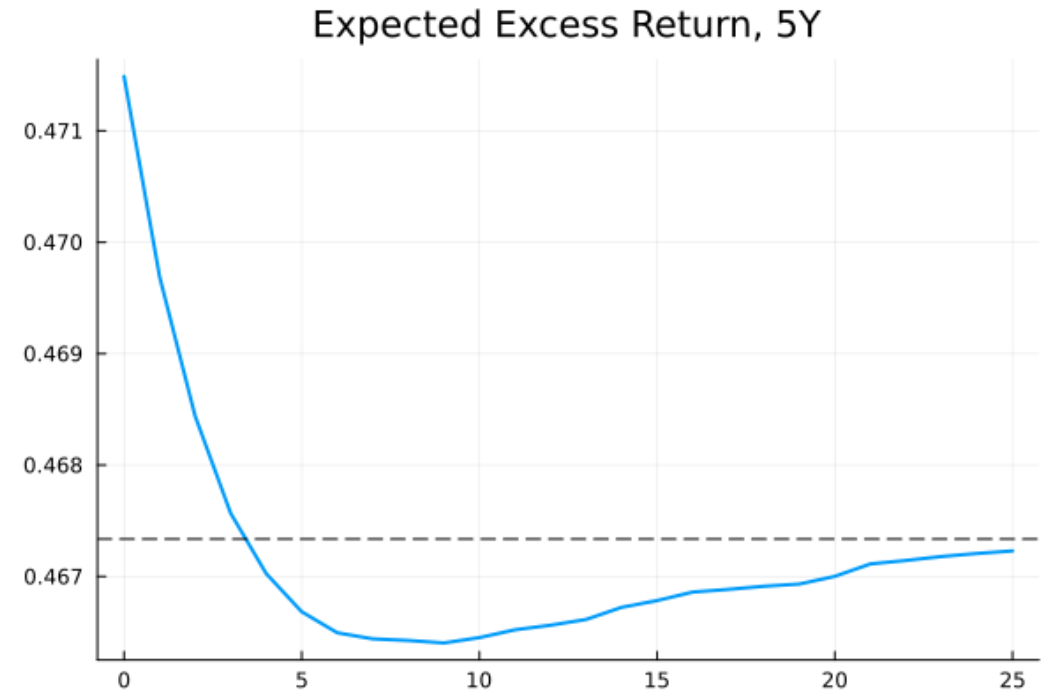


Positive Bond Risk Premia In MD Regime

Yield Curve At Stochastic Steady State

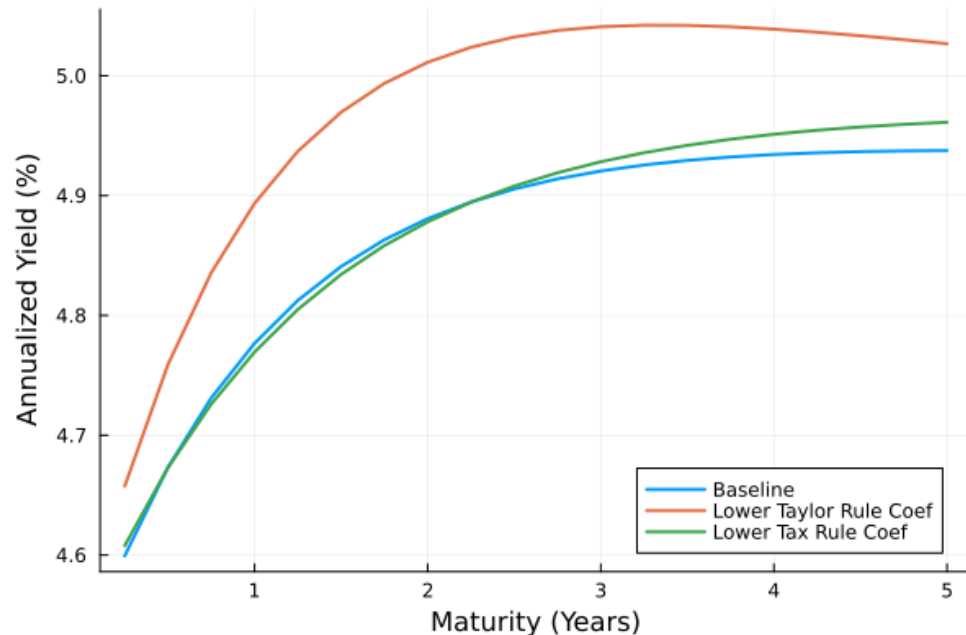


Spending Shocks Slightly Increase Risk Premia

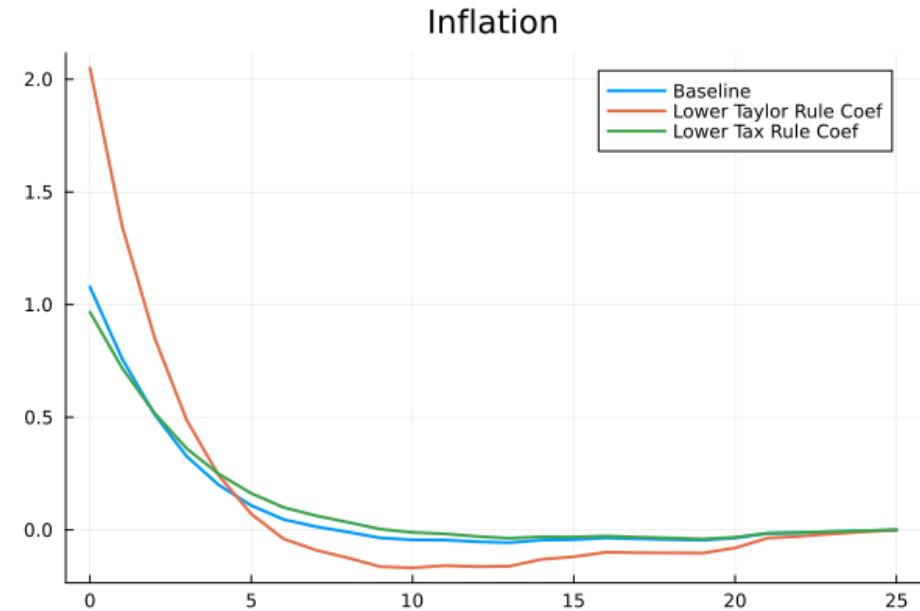


Less Active MP/More Passive FP → Larger Effects

**Higher Risk Premia:
Yield Curve At Stochastic Steady State**

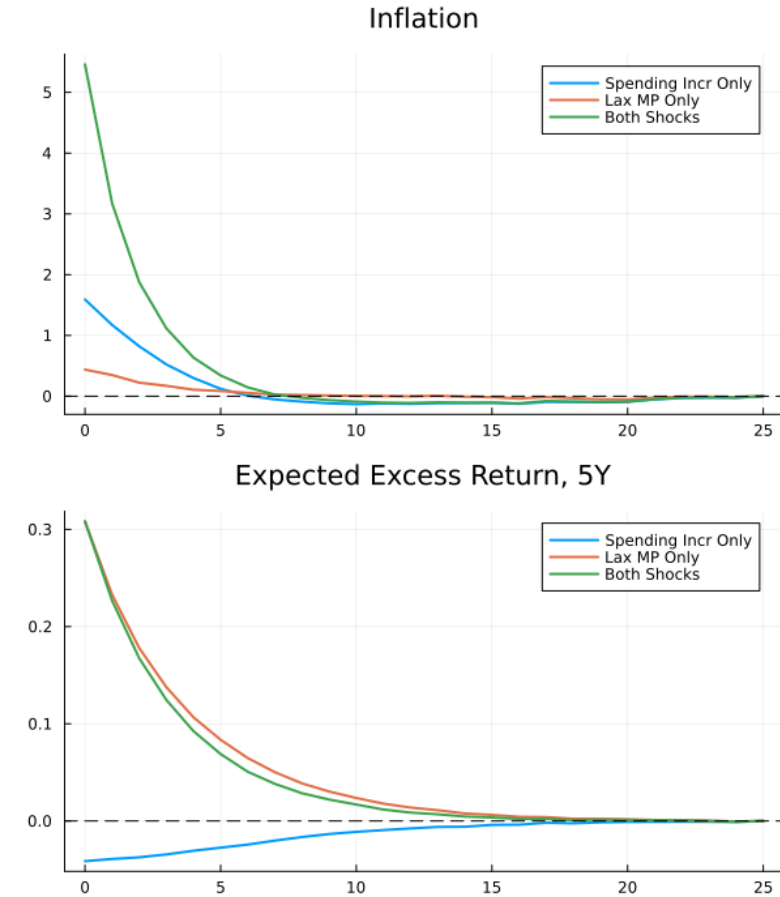


**Larger Inflation:
Impulse Response to Spending Shock**



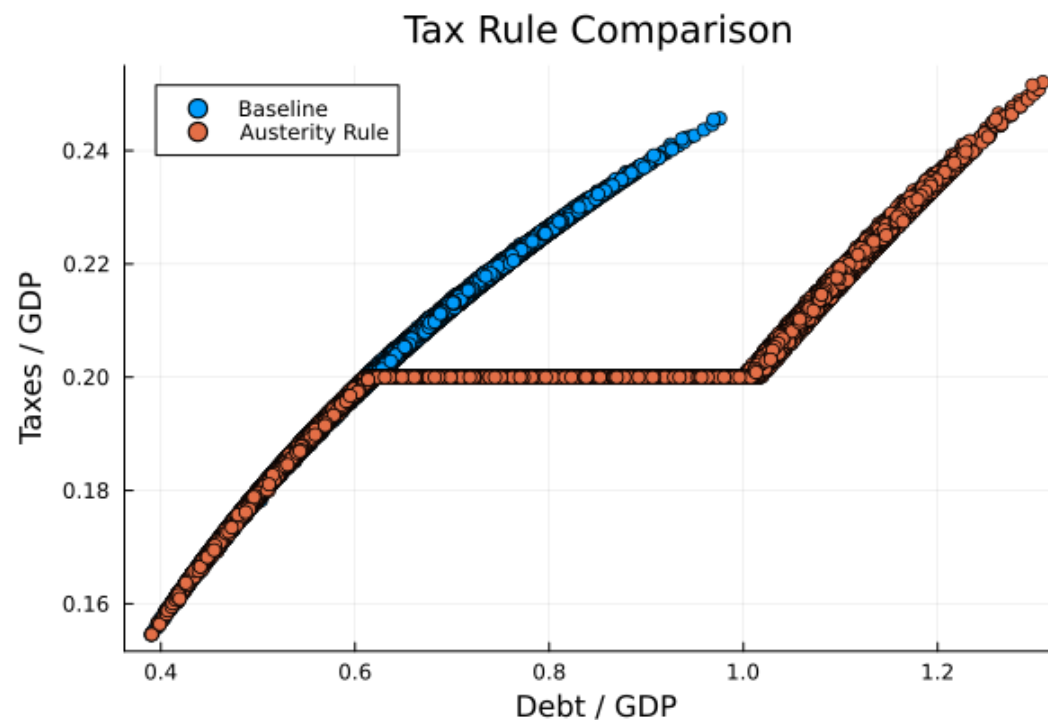
Temporary Fiscal Dominance

- ~Diamond, Landvoigt, Sanchez (2024)
- Add exogenous shock to Taylor Rule coefficient on inflation
- $\rho_{\pi,t} = (1 - \phi) \bar{\rho}_{\pi} + \phi \rho_{\pi,t-1} + \sigma_{\rho} \epsilon_t^{\rho}$
- Discretize and consider shock large enough that $\rho_{\pi,t} < 1$
- Inflationary in itself
- Makes spending shocks much more inflationary (than even permanently lower Taylor rule coefficient)
- Substantial source of variation in bond risk premia



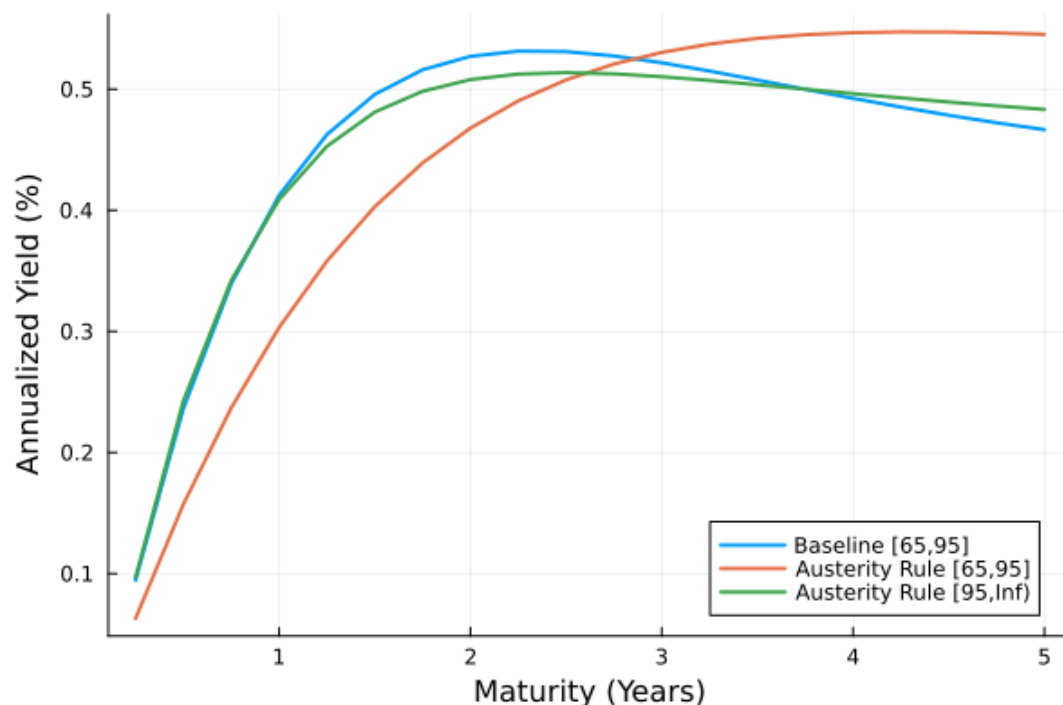
Delayed Tax Response

- Is (some of) the spending unfunded?
 - no relationship between taxes and debt/GDP in the data
 - But what if we haven't observed the adjustments **yet**?
- Elenev, Landvoigt, Van Nieuwerburgh (2025): tax response is delayed until debt/GDP gets high enough (“austerity region”?)
- Introduce ELVN tax rule into GCKLZ model

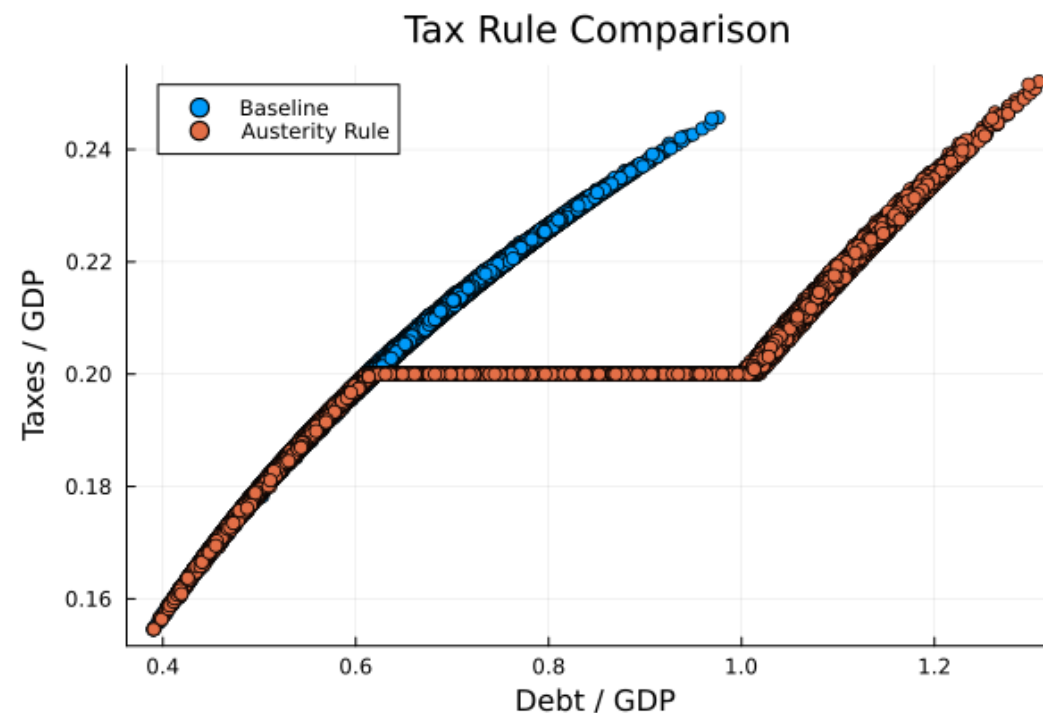


Delayed (but still occurring) tax hikes insure both taxpayers and asset-holders at short horizons

Expected Excess Returns



Tax Rule



What appears locally to be “active” fiscal policy lowers, not raises, risk premia

Conclusion

- Tax and inflation dynamics different in monetary and fiscal dominance regimes
- “Unfunded” spending redistributes from bondholders to taxpayers
- Policy-driven source of bond risk premia
 - But different (?) policy than, e.g., shocks to inflation target (Rudebusch and Swanson)
- Well-written paper with elegant model on important topic!
 - Easy framework to extend → enabled me to do some cool experimentation
 - Explaining bond risk premia is important
 - Using bond price dynamics to infer policy regime arguably as important
- My ask: clarify when that inference can be made