

**The impact of fiscal policy shocks
on Romanian economy and CEE countries
- Non-technical summary -**

Dr. Petre Caraiani

The study investigates the fiscal policy in Central and Eastern European countries using evidence from the four most important economies, Czech Republic, Hungary Poland and Romania. A two-country open economy model with a Taylor fiscal rule is estimated on quarterly data for these countries. The study explores the potential of counter-cyclical fiscal policy in the context of the ongoing financial crisis, the reaction of the fiscal policy to negative demand shocks or to a more relaxed monetary policy, as well as the impact of fiscal shocks.

The most important results are the following:

1) The fiscal rule can act as an automatic stabilizer in the context of negative domestic and external demand shocks;

2) In these countries the fiscal policy can positively influence the output when negative shocks from Euro Area affect the economy.

3) There are differences with respect to the reactions of macroeconomic variables in these economies, with respect to both the magnitude and persistence of responses.

3) Based on the historical decomposition, there are evidences that fiscal shocks during the last years behaved in a pro-cyclical way and it appears that the countercyclical potential of fiscal policy during the financial crisis remained largely unused.

4) Running counterfactual scenarios shows that a considerable government spending effort would have improved the dynamics of output during the crisis for three of the countries, namely Czech Republic, Hungary and Romania.

5) Using the Bayesian comparison approach, the study also finds evidence in the favor of including the fiscal Taylor rule against the alternative of simple AR(1) processes for the fiscal variable.

Keywords: DSGE models, small open economy, CEE countries, fiscal policy, monetary policy.