

Abstract

This thesis investigates the effects of government spending on aggregate economic variables in the Czech Republic. The standard RBC and New Keynesian models assume only forward-looking households despite the evidence of a significant fraction of non-optimizing households. These models do not provide reasonable predictions for the response of consumption: both models predict its fall following a government spending shock. Therefore, a variant of the New Keynesian model, where rule-of-thumb households coexist with optimizing households, is used for the analysis.

We have found that fiscal policy has a positive impact on output, although government spending multiplier does not exceed one. Also, the impact on consumption is positive for several periods following a fiscal spending shock, which is consistent with the evidence.

JEL Classification: C32, E32, E62

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