Discussion of
Monetary-Fiscal Crises, Reforms, and Reversals in Three Countries

by Saki Bigio and Tom Sargent

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Chile, Argentina, Peru

• Similar history of populism, expropriation and nationalizations, debt crises and high inflation

• All eventually implemented similar reforms
  • privatization of state-owned enterprises and social security programs
  • central bank independence
  • fiscal rules

• Reforms were initially successful
  • maintained in Chile and Peru
  • reversed in Argentina
A theory of reforms?

• What constitutes a successful/sustainable reform?

• Discuss an example
  • based on joint work with M. Aguiar

• Distinguish between
  • Reforms that only change the state variable
  • Reforms that also change the driving forces
A “reputational” SOE model

- Small open economy, facing interest rate: $R < 1/\beta$
- Domestic firms: $f(k, l)$
- Government subject to political disagreement
- Political disagreement: $\theta$, higher values $\rightarrow$ more disagreement
The political problem

Find
\( \{g_t, k_t\}_{t=0}^{\infty} \)

\[
\max_{t=0} \sum_{t=0}^{\infty} \beta^t g_t
\]

\[
b_0 \leq \sum_{t=0}^{\infty} R^{-t} (f(k_t) - (r + \delta)k_t - g_t)
\]

\[
\theta g_t + \sum_{s=t+1}^{\infty} \beta^{s-t} g_s \geq W(k_t), \quad \forall t
\]
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Budget constraint

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Sustainability constraint

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Sustainability constraint
The outcome

• multiplier on sustainability constraint: $\lambda_t$

higher values mean more distortions (i.e., lower capital)
The outcome

- multiplier on sustainability constraint: $\lambda_t$

$$\lambda_{t+1} = 1 - \beta R + \beta R (1 - 1/\theta) \lambda_t$$
The outcome

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The outcome

- multiplier on sustainability constraint: \( \lambda_t \)

\[
\lambda_{t+1} = 1 - \beta R + \beta R (1 - 1/\theta) \lambda_t
\]

more debt, more distortions

\[\lambda_\infty\]
Intuition

• frontier between debt and efficient investment:
  • accumulation of government debt leads to
    • a starving government
    • that cannot commit not to tax and expropriate
  • over long periods of time: sovereign debt accumulation is associated with shrinking economies
A temporary reform

\[ \lambda_{t+1} \]

\[ \lambda_t \]

more distortions

45%
A temporary reform

\[ \lambda_{t+1} \]

more distortions

\[ \lambda_{\infty} \]

45%
A temporary reform

\[ \lambda_{t+1} \]

\[ \lambda_t \]

more distortions
A permanent reform

\[ \lambda_{t+1} \]

\[ \lambda_{\infty} \]

A reduction in \( \theta \)

more distortions
A permanent reform

A reduction in $\theta$

$\lambda_{t+1}$

$\lambda_t$

$\lambda_\infty$

more distortions
A permanent reform

\[ \lambda_{t+1} \]

\[ \lambda_t \]

\[ \lambda_\infty \]

A reduction in \( \theta \)

more distortions

45%
• emphasized link between debt and inefficiencies and the interaction of that trade-off with political economy

  • countries with more disagreement — end up with more debt and more distortions

• But …

  • what is the role of state-owned enterprises? pension funds?

  • what about default and its costs?

  • the role of shocks and uncertainty

  • inflation as an alternative policy tool
Some final comments

• Question: how does a change in the political game get engineered and sustained?

• Strong executive
  • But what if we draw a crazy executive? and why are these persistent?

• Agents learn about the benefits of reforms (Buera, Monge-Naranjo, Primiceri, 10)
  • Past experience and neighbors’ experiences — Chile in LatinAm
  • Affected by shocks and temporary reversals

• External conditionality — carrots: ROE compensates SOE in the future for good behavior
  • Foreign debt eats the carrots: ROE is owed by the SOE

• Looking forward to learn a lot from this conference