

Discussion of

**Monetary-Fiscal Crises, Reforms,
and Reversals in Three Countries**

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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: θ , higher values \rightarrow
more disagreement

The political problem

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

$$\max \sum_{t=0}^{\infty} \beta^t g_t$$

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

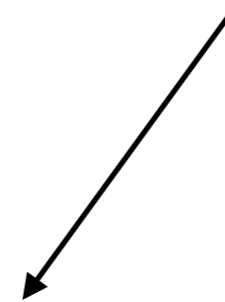
$$\theta g_t + \sum_{s=t+1}^{\infty} \beta^{s-t} g_s \geq \underline{W}(k_t), \quad \forall t$$

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Budget constraint



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Sustainability constraint

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Political disagreement

Sustainability constraint

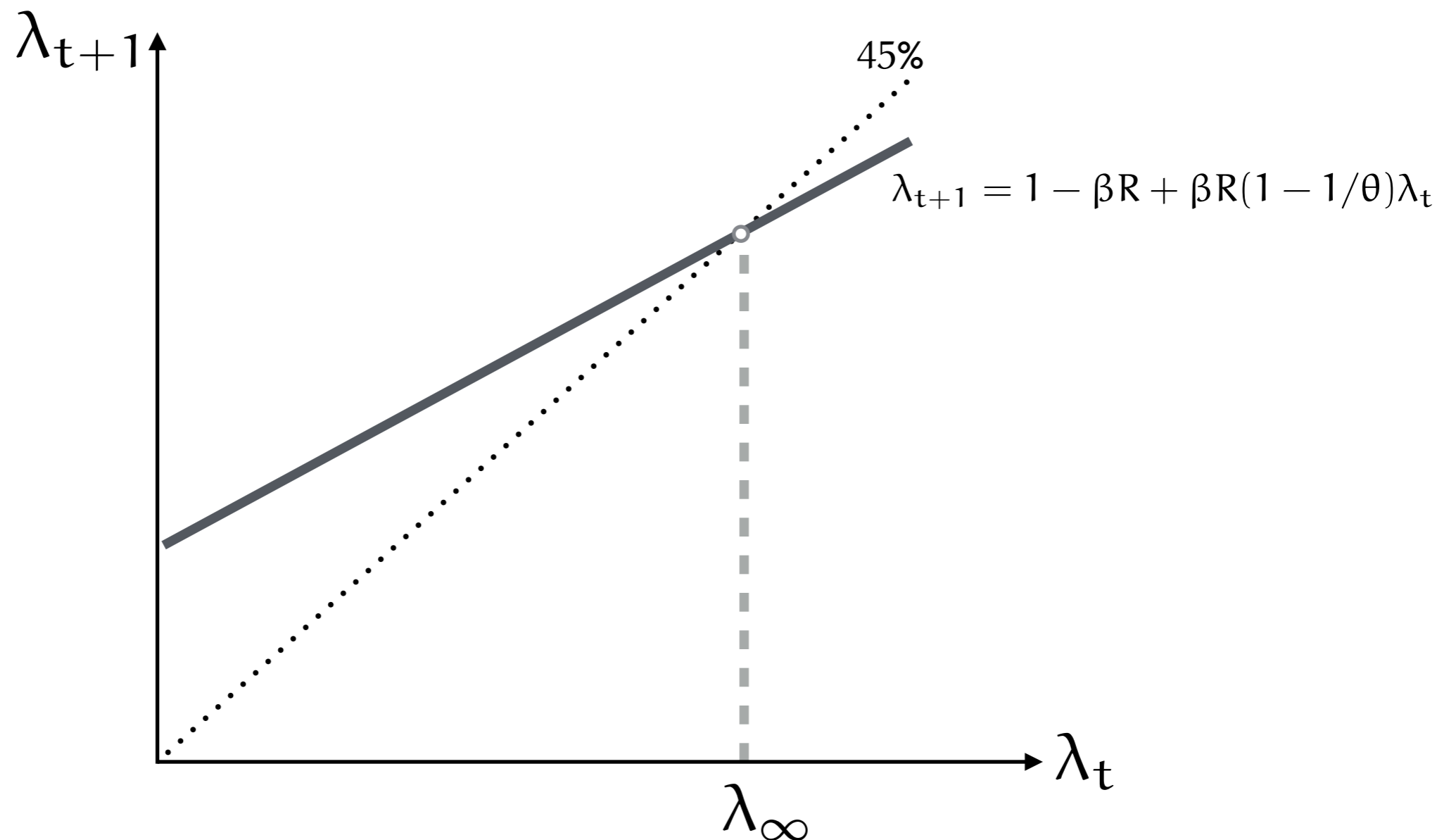
The outcome

- multiplier on sustainability constraint: λ_t

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

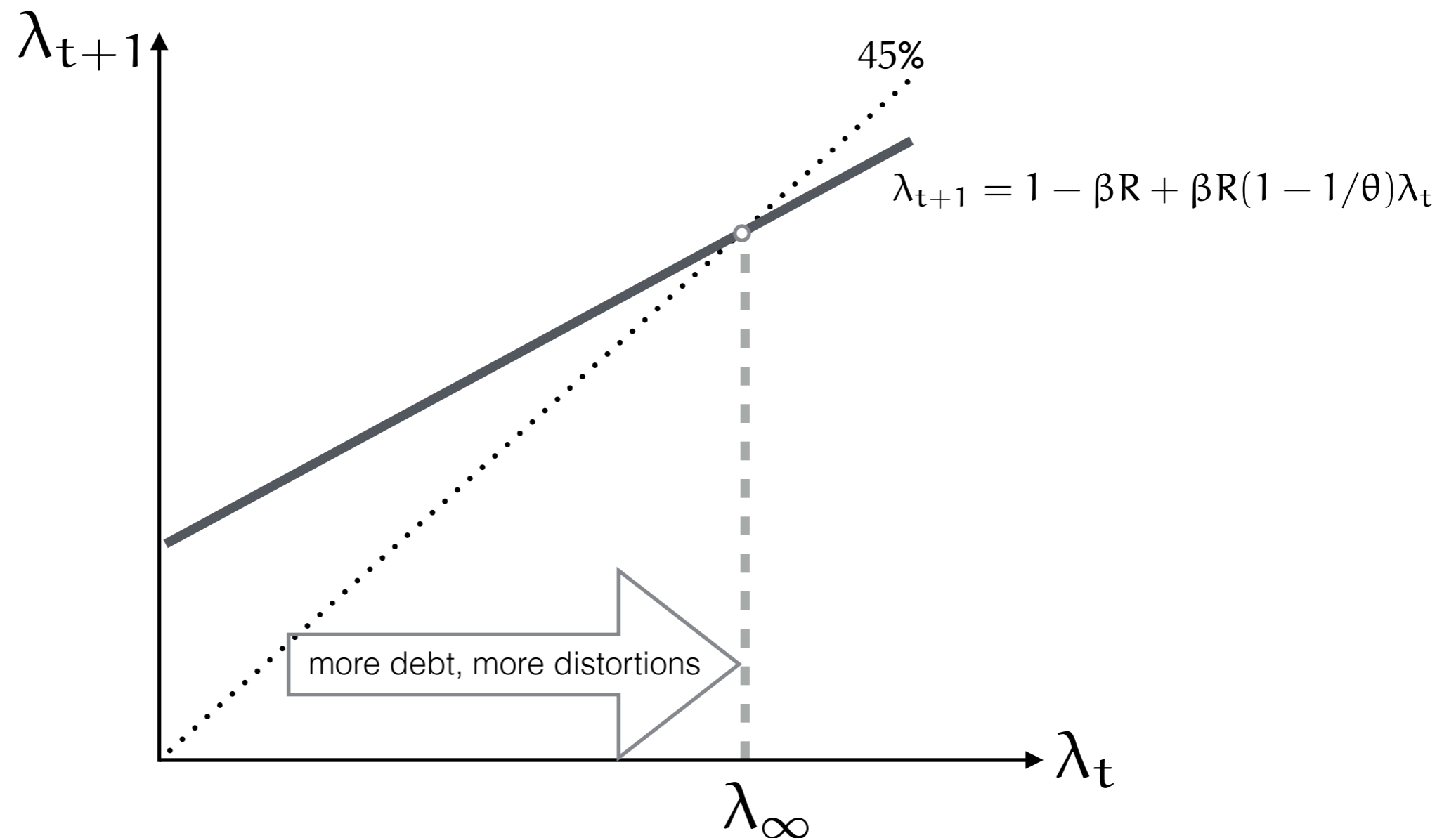
The outcome

- multiplier on sustainability constraint: λ_t



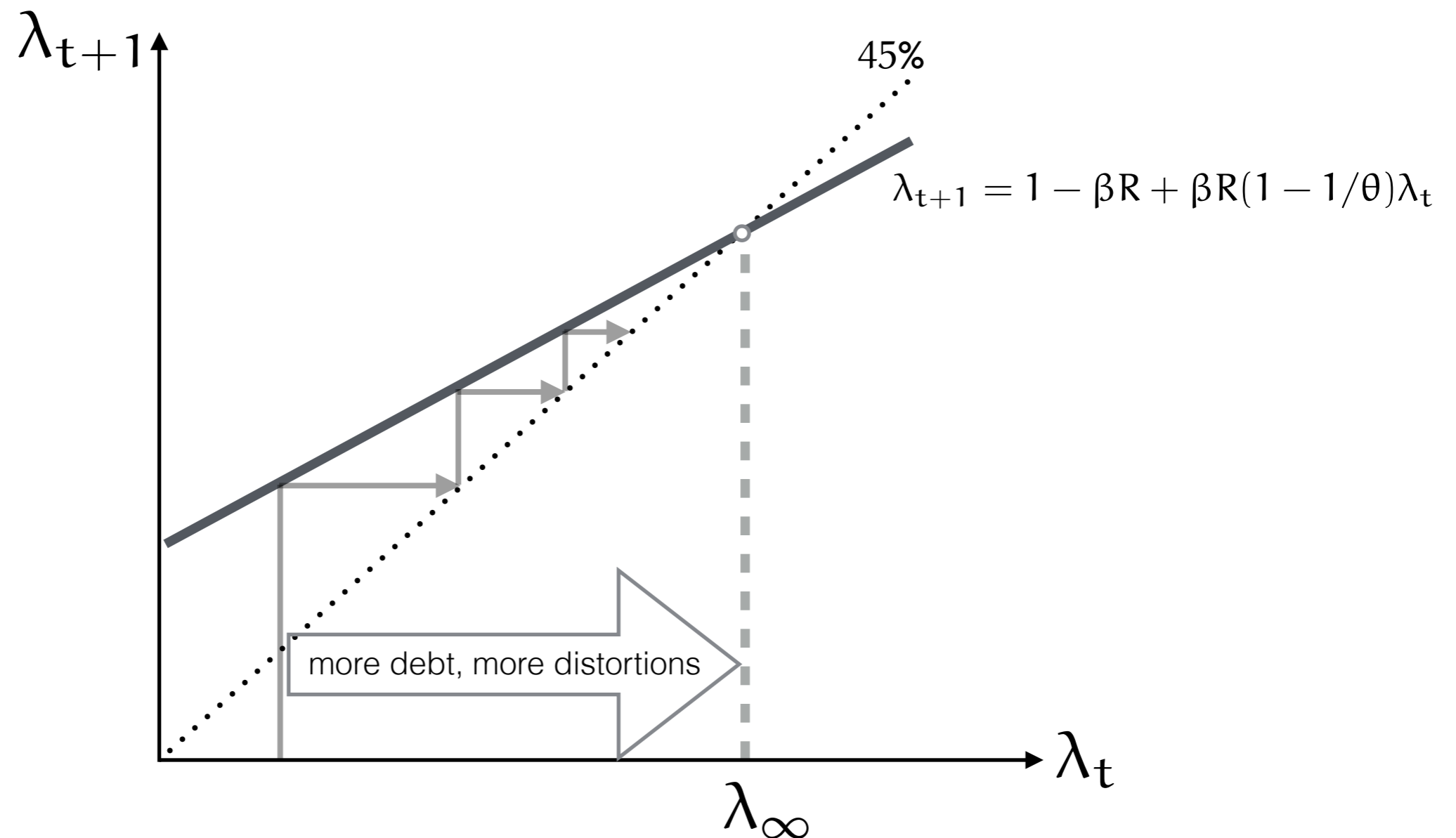
The outcome

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The outcome

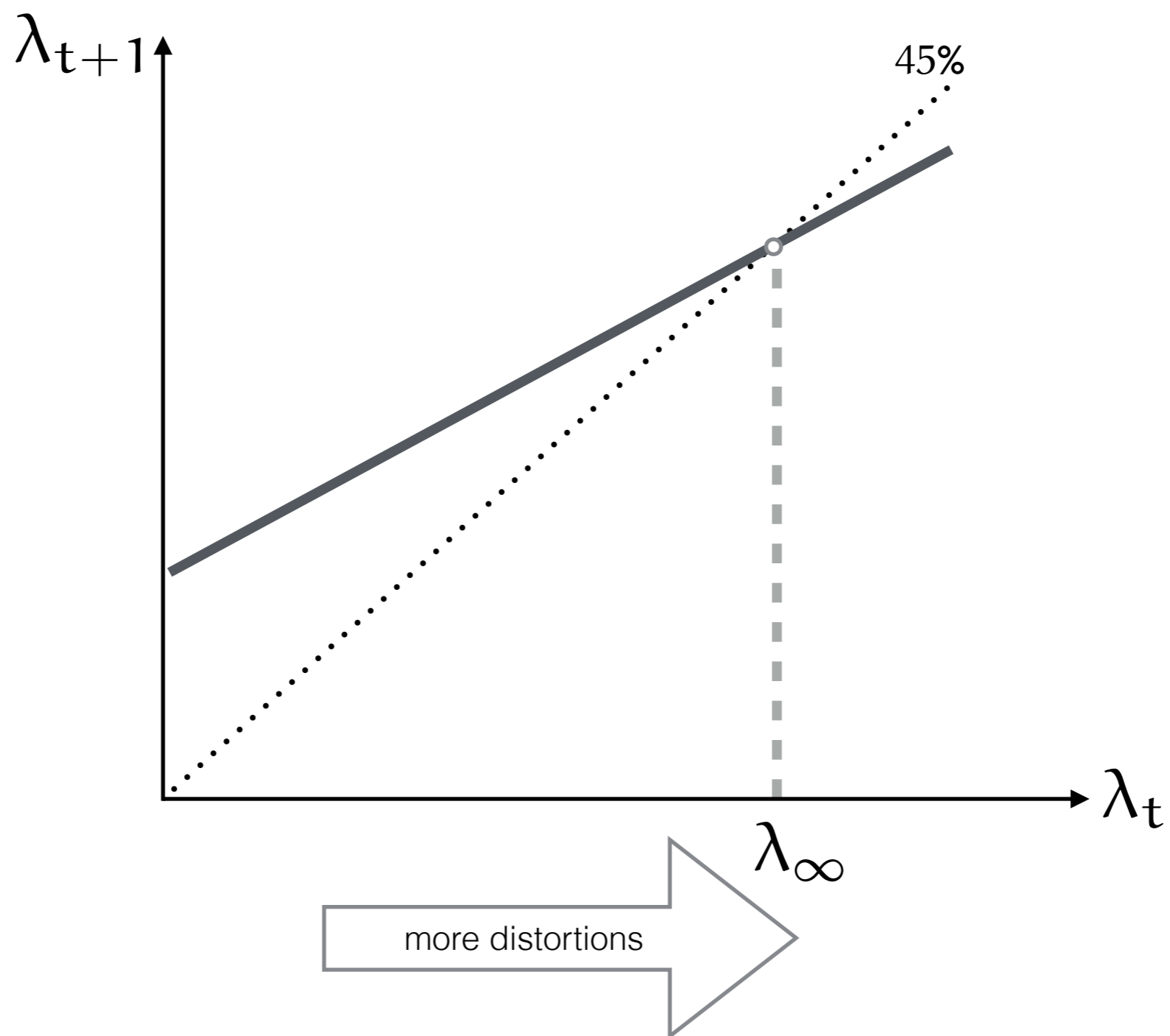
- multiplier on sustainability constraint: λ_t



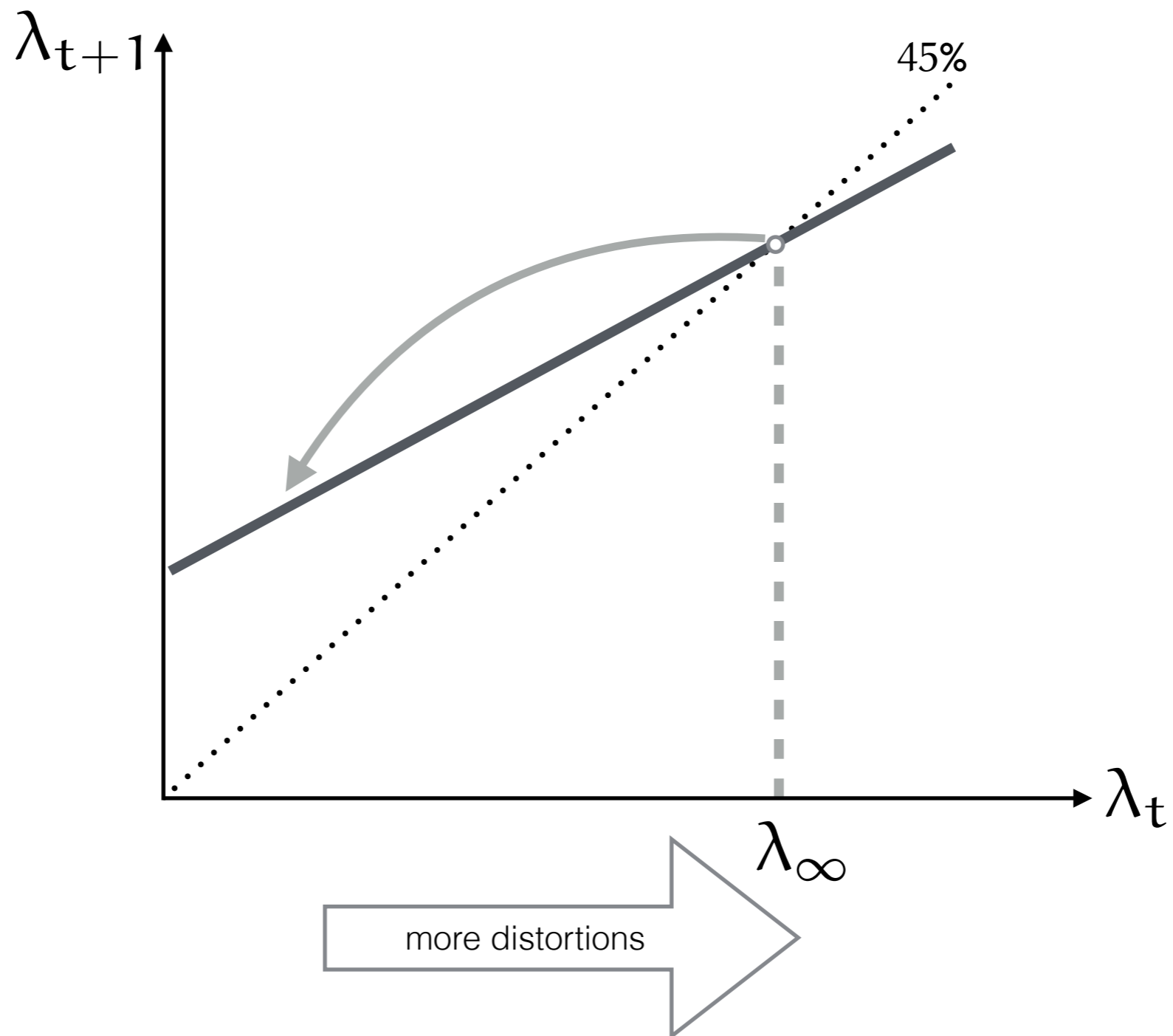
Intuition

- 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

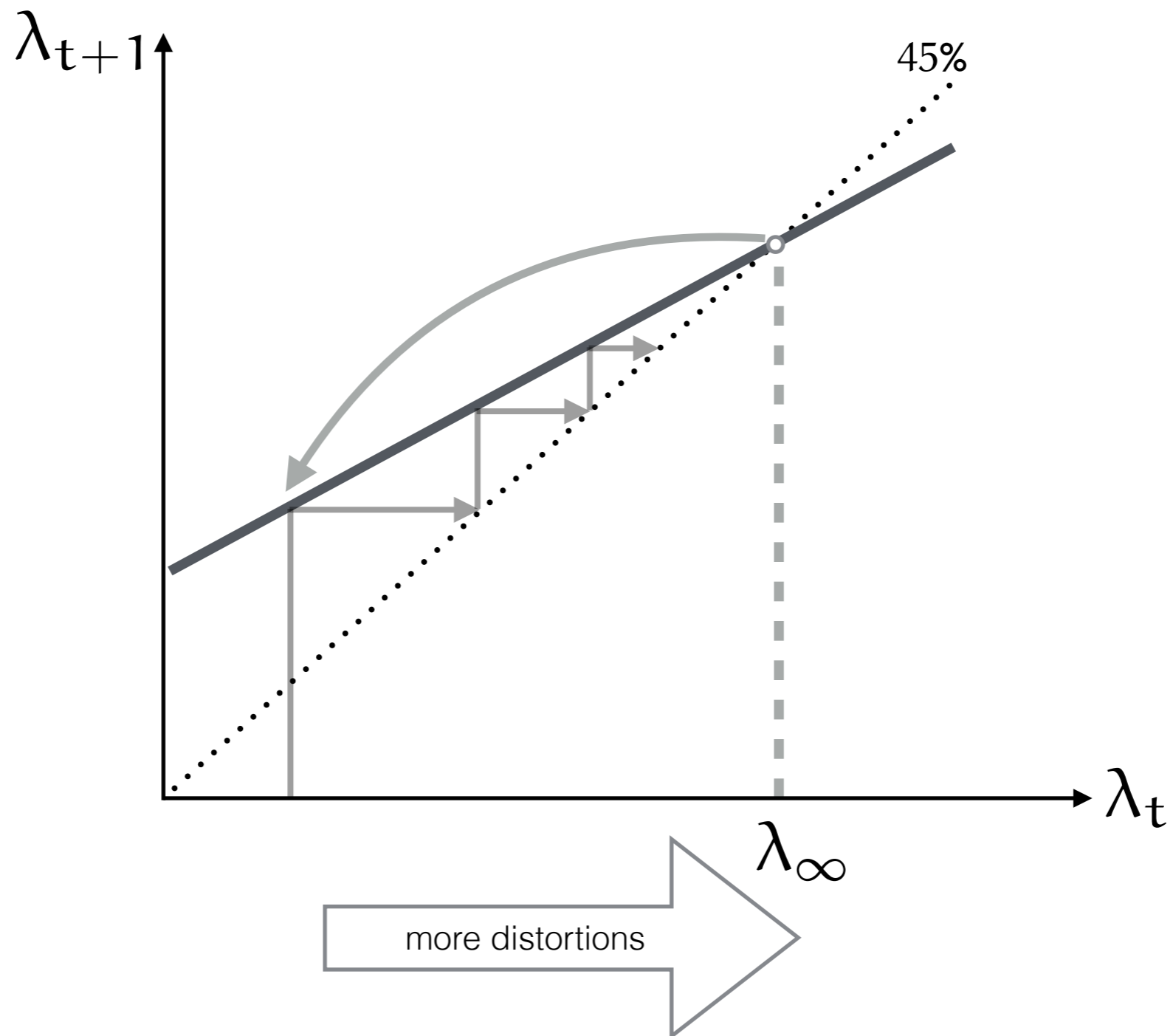
A temporary reform



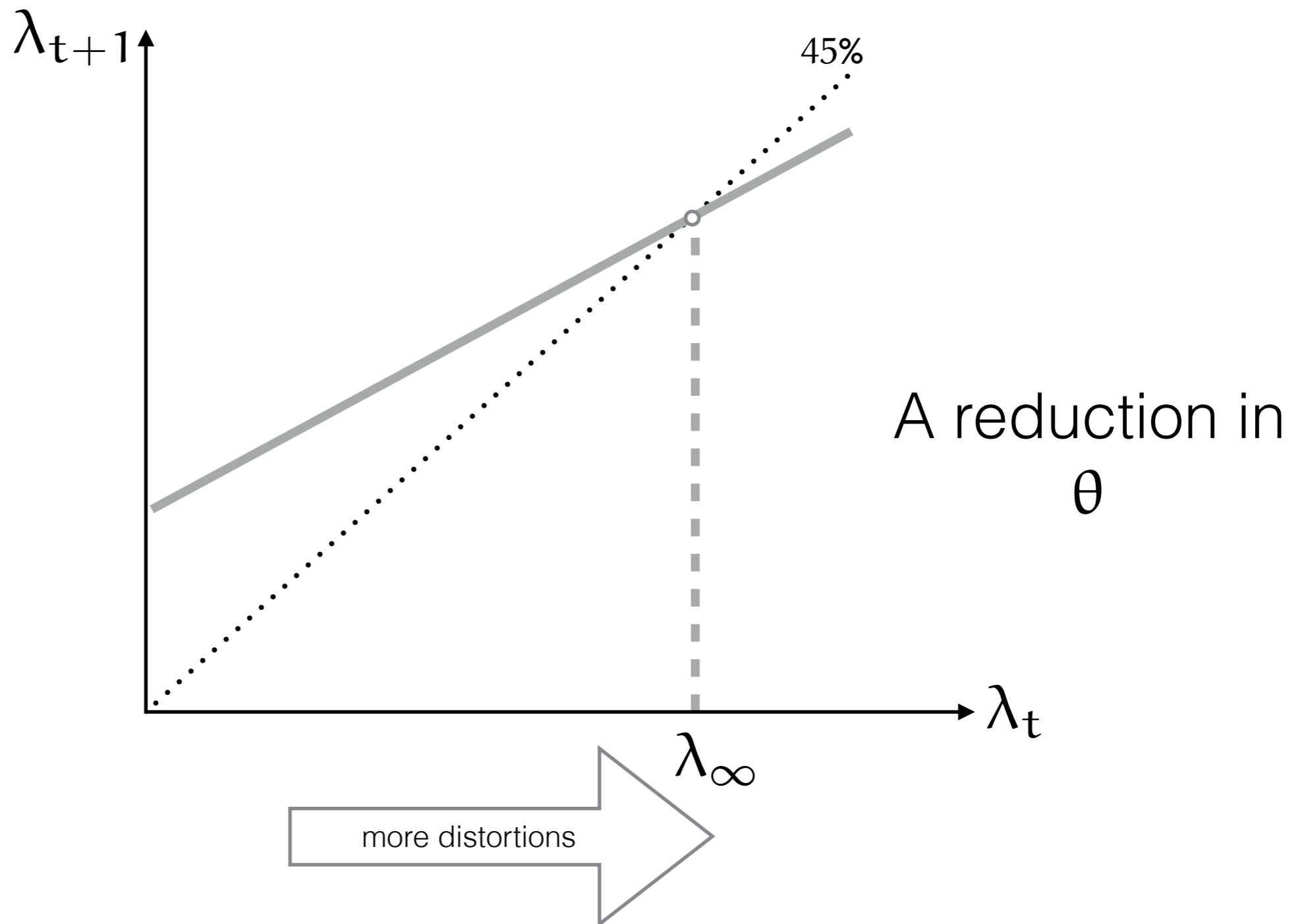
A temporary reform



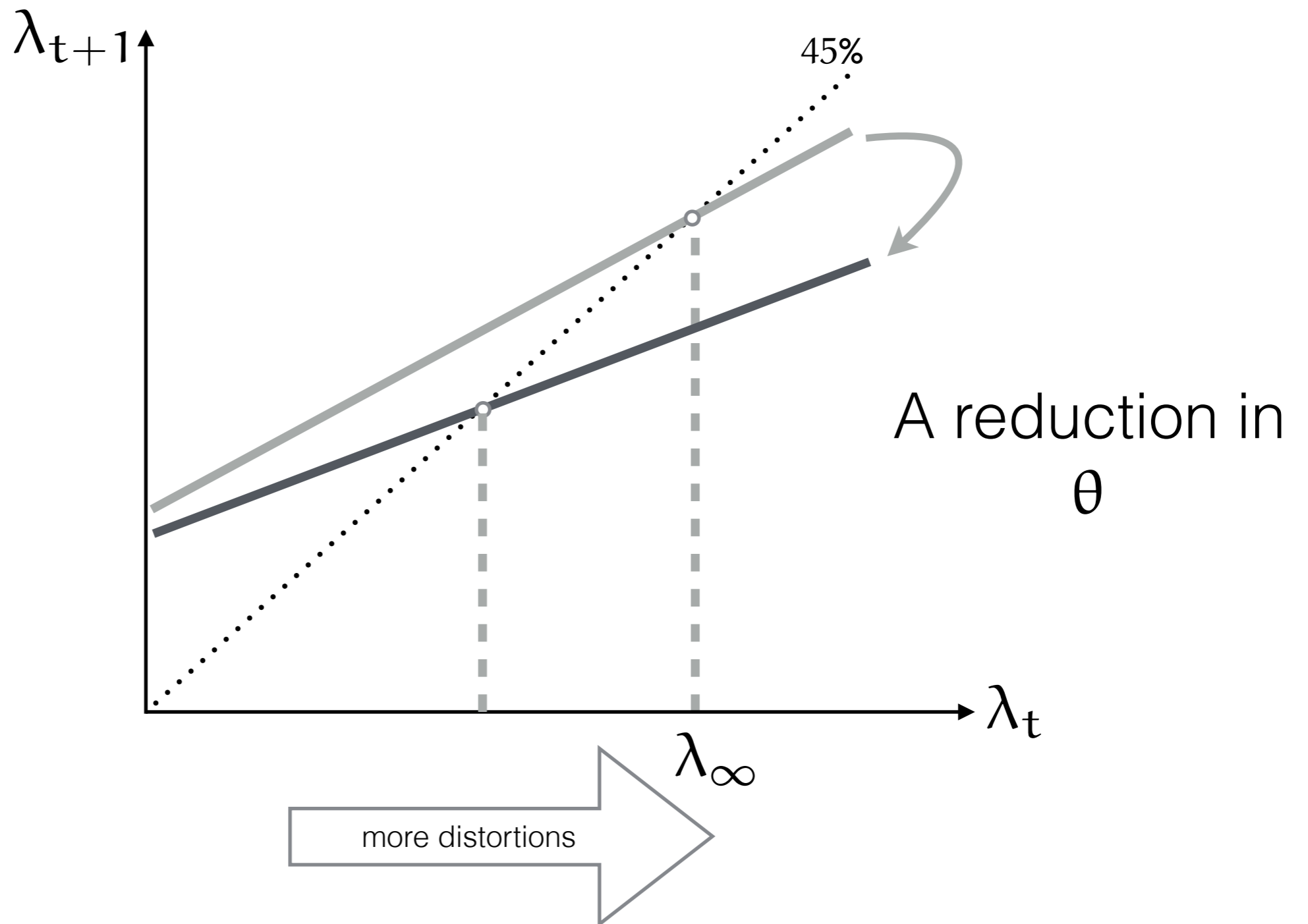
A temporary reform



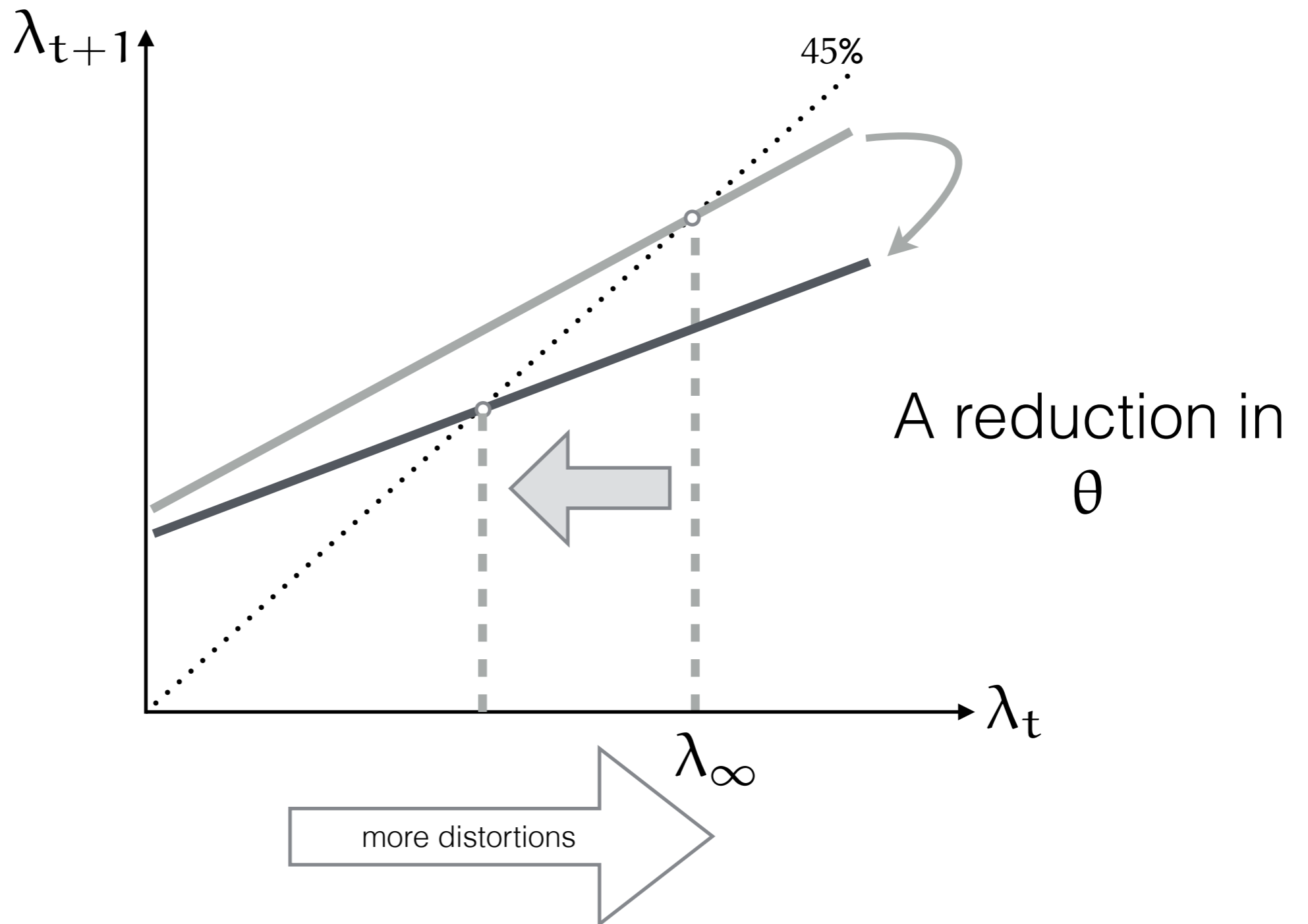
A permanent reform



A permanent reform



A permanent reform



Missing

- 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