

Optimal Austerity- Conesa, Kehoe, & Ruhl

Discussion

Amanda Michaud- Indiana U (2017)

- Conesa & Kehoe (2015)- Gambling for redemption
 - Deep recession lowers (exogenous) fiscal revenue and throws economy into crisis zone
 - If close to safe threshold- pay down debt and escape
 - If far from safe, hope for switch to recovery to exit crisis zone.

- Conesa, Kehoe & Ruhl (CKR) (2017)- Optimal Austerity
 - Tax policy is a choice. Fiscal revenue endogenous.
 - New tradeoffs:
 - Domestic tax vs. foreign borrowing
 - Consider ability to commit to fiscal policy.

Main Takeaway

Is austerity optimal in a recession?

	Commitment	No Commitment
Crisis Zone	Yes	Yes
Close to Crisis Zone	Yes	No
Far from Crisis Zone	No	No

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Welfare implications of commitment

- Ex-ante Welfare: Higher debt sustainable.
- Ex-post Welfare:
 - High debt + recession, more able to avoid default
 - Mid-debt + recession = painful austerity, taxes increase 20ppt.

- 1 Can't change debt maturity.
 - Would want to lengthen. (Cole & Kehoe; Bocola & Dovis)
- 2 Can't hold reserves.
 - May want to. (J. Hernandez 2016-JMP) Probably not quantitatively relevant.

Is the complication worth the hassle? Probably not.

- Main point goes through
- But, more avenues to think whether commitment matters.

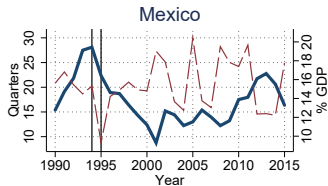
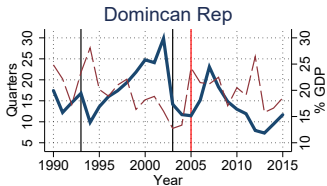
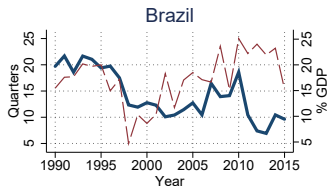
What do the data say?

- Want: test prediction for austerity near crisis zone.
 - Commitment: Fiscal Contraction
 - No Commitment: Fiscal Expansion
- Problem: how to identify crisis zone
- Strategy: follow Bocola & DAVIS
 - Identify “bad times” by increase in spread
 - In crisis zone if accompanied by increase in maturity

Maturity & Debt- Latin America

Government Debt

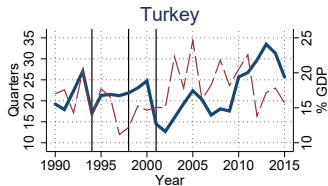
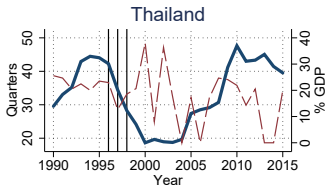
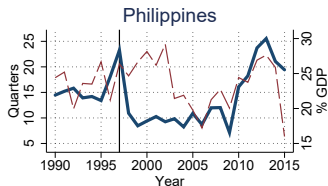
Size and Average Maturity on New Debt



Red Lines = Defaults, Black Lines = Sudden Stops

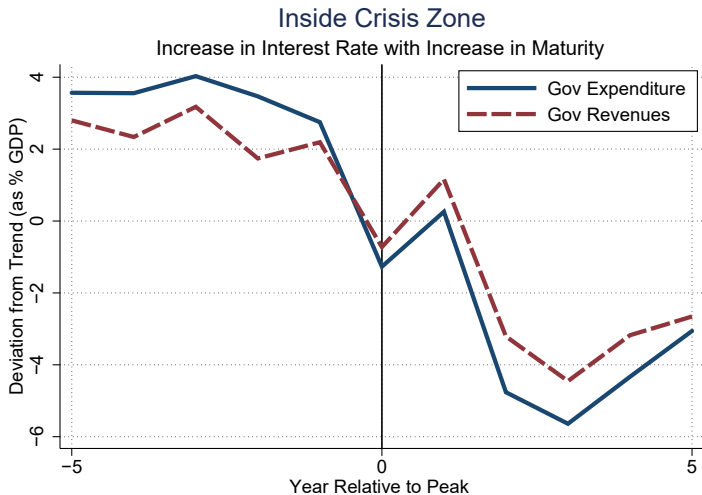
Maturity & Debt- Asia

Government Debt Size and Average Maturity on New Debt

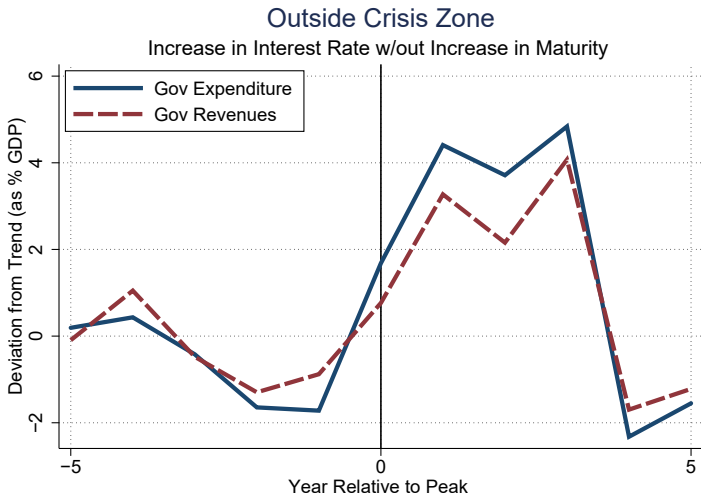


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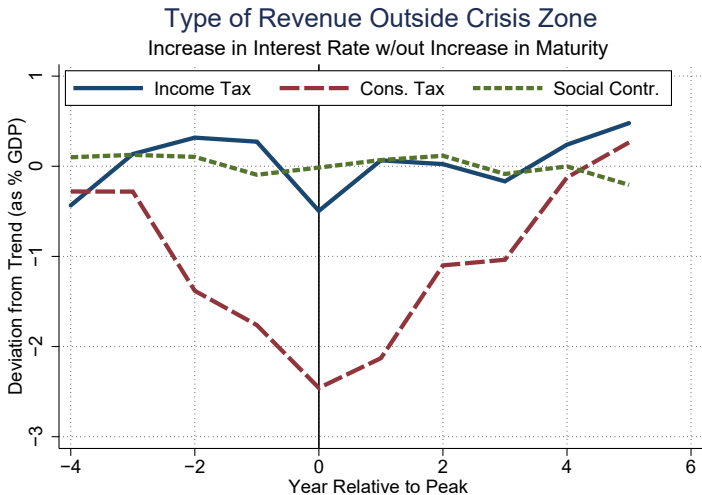
Test- Austerity in Crisis Zone?



Test- Austerity in (Near) Outside of Crisis Zone?



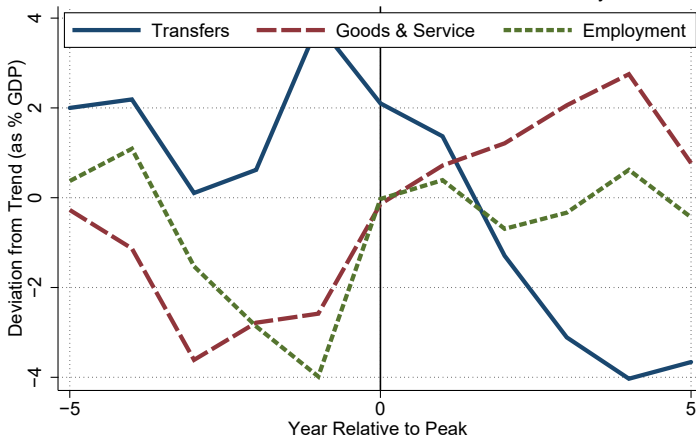
Composition of Fiscal Expansion



Composition of Fiscal Expansion

Type of Expenditure Outside Crisis Zone– 2007

Increase in Interest Rate w/out Increase in Maturity



Natural research progression

- 1 Build models of fiscal policy w/ and w/out commitment
- 2 Test implications
 - I found some evidence for lack of commitment.
- 3 Look at empirical counter-examples for clues of where commitment comes from.

Thoughts for this paper

- 1 Consumption tax seems more supported by data. Does it matter?
- 2 Mention restrictions on choices (debt maturity and reserves) for future quant studies.
- 3 Could relate to Mendoza's 2001 NBER macro annual that had fiscal uncertainty (Calvo & Drazen, 1998) in which unexpected tax hike *causes* a sudden stop through a binding liquidity constraint on private debt.

- Default dates from Cruces & Trebesch (AEJ-Macro 2013)
- Sudden Stop dates from Jeanne & Ranciere (EJ 2011) or Calvo, Izquierdo, Majia (2004 WP)
- Data from the World Bank
 - Average maturity on new external debt, official. (DT.MAT.OFFT)
 - Average interest rate on new external debt commitments, official. (DT.INR.OFFT)
- De-trended w/ linear-quadratic country-series trend.