Discussion of “Tackling Fiscal Challenges,” by Mark Aguiar, Princeton University

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Is public debt market access a net negative?

- Very interesting and thought-provoking paper
  - Related to Mark's 2023 Mundell-Fleming's lecture, Aguiar (2024)
- Main thesis: Public debt access can be a net-negative
  - Data: capital allocation puzzle, Gourinchas-Jeanne
  - Theory: Aguiar-Amador
- Search for channels that can make market access a net-positive
  - Propose new avenues for research

Mark’s argument

- Standard logic: Public debt access is a net-positive
  - Access to (public) debt market allows for
    - Speed up convergence: faster capital accumulation, R&D, etc.
    - Consumption/tax smoothing
- Mark’s logic: Public debt access can be net-negative
  - Data:
    - Capital allocation puzzle
      - Most growing countries are reducing public indebtedness
      - Public debt and private investments (and private external debt) are substitute
    - Countries with more debt have more volatile outcomes
  - Theory: Political economy frictions that lead to present-bias/myopic policymakers
    - **Aguiar-Amador, Growth in the Shadow of Expropriations**

My discussion

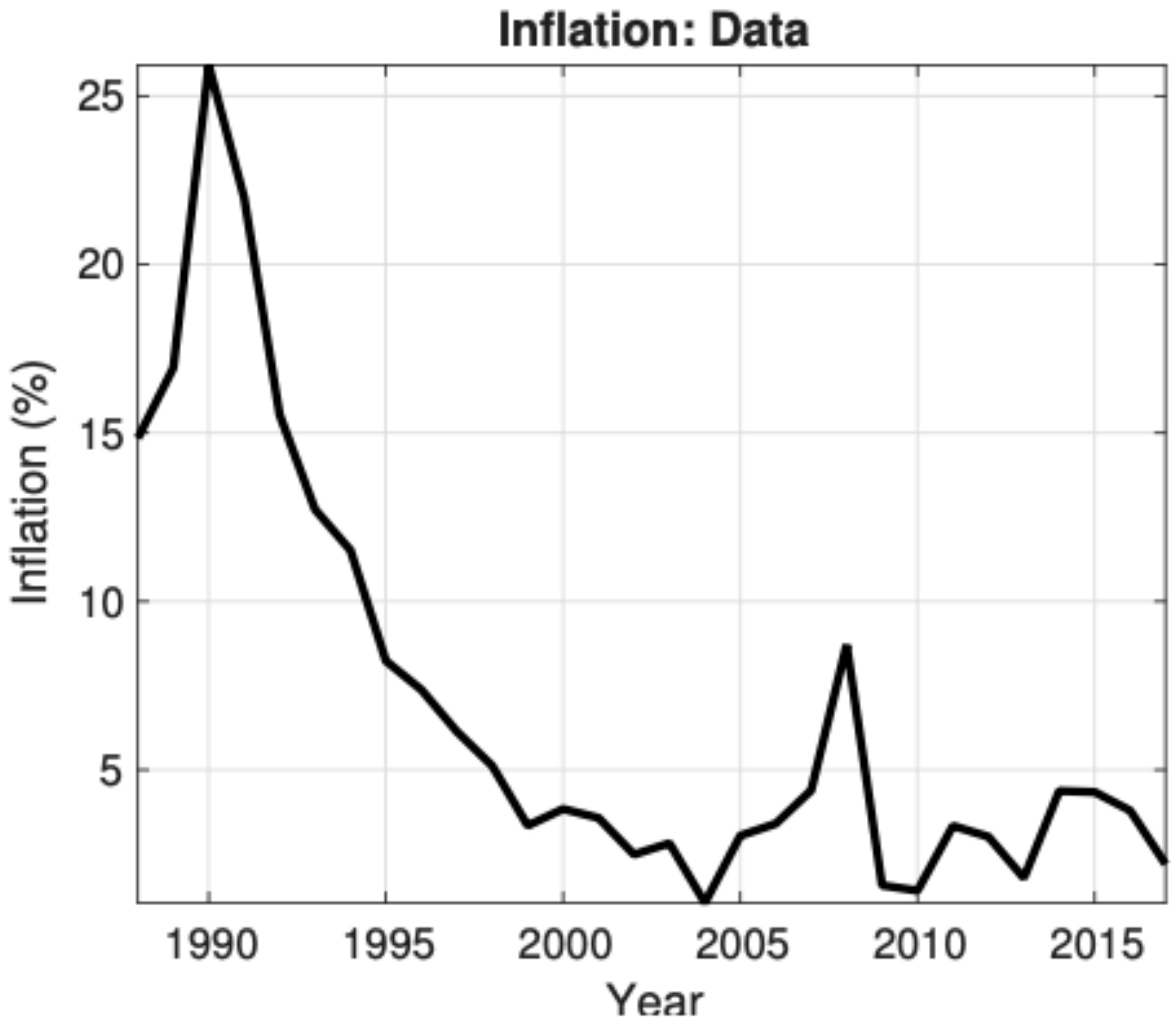
- I will make 3 comments
  - Why market access can be good?
    - Deeper market access allows for lower and more stable inflation
    - Some of my recent work, Bocola-Chaumont-Dovis-Kirpalani
      - Credibility to low inflation is necessary for supporting high public debt
  - Limiting political risk and present-bias: Optimal institutional design
    - Fiscal rules, fiscal councils, …
  - Role of IMF and other large institutions

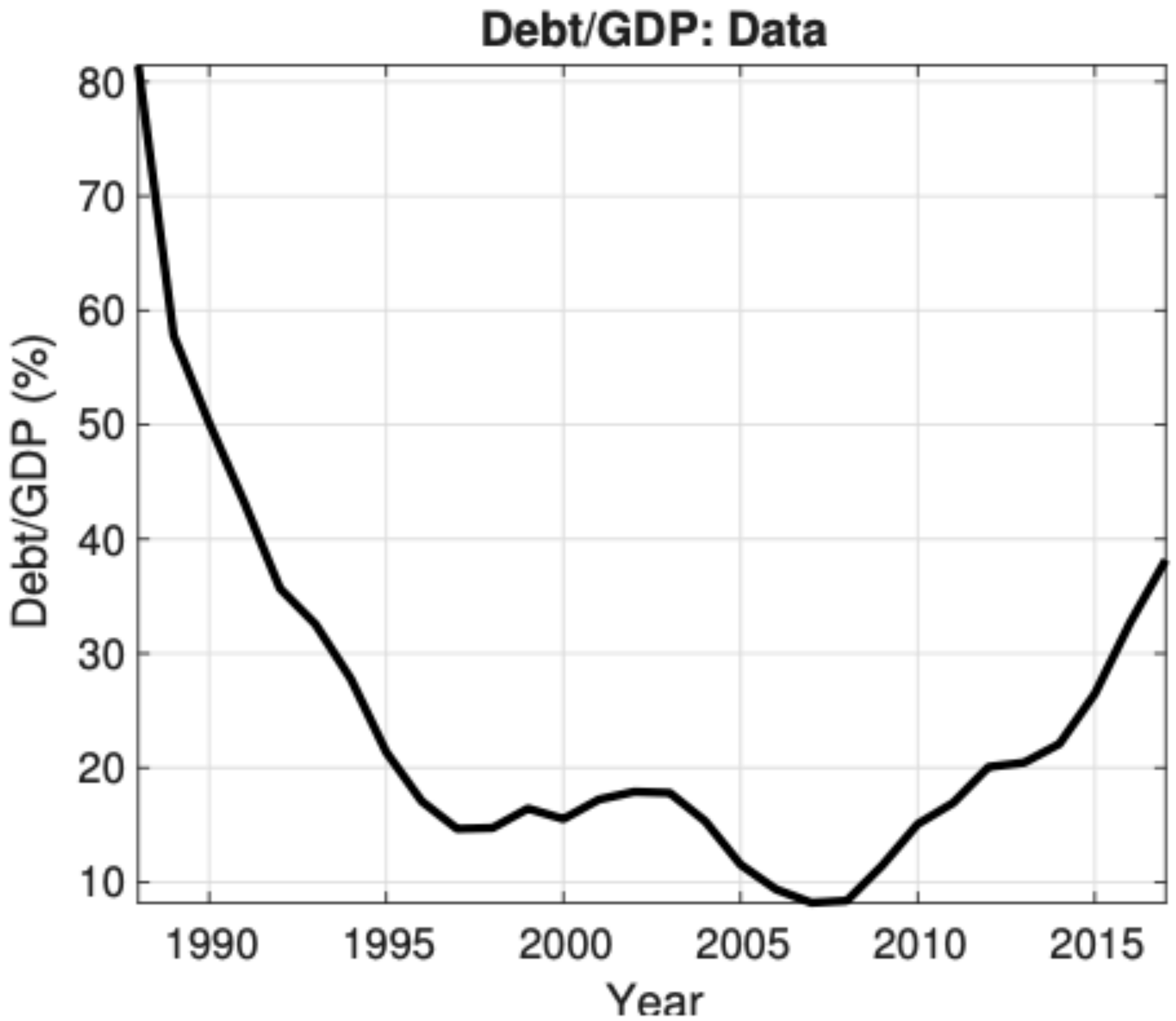
Debt market access and inflation

- **How much of the observed disinflation has been due to fiscal consolidation versus deeper and more reliable public debt markets?**
- Why market access can be good?
  - From classic Sargent-Wallace:
    - Periods of high inflation are often determined by fiscal indiscipline
    - Central bank forced to produce seigniorage for the treasury/government
  - Market access provides alternative financing channel to seigniorage
    - Less pressure on central bank to generate seigniorage
    - Lower and more stable inflation

Public debt and inflation

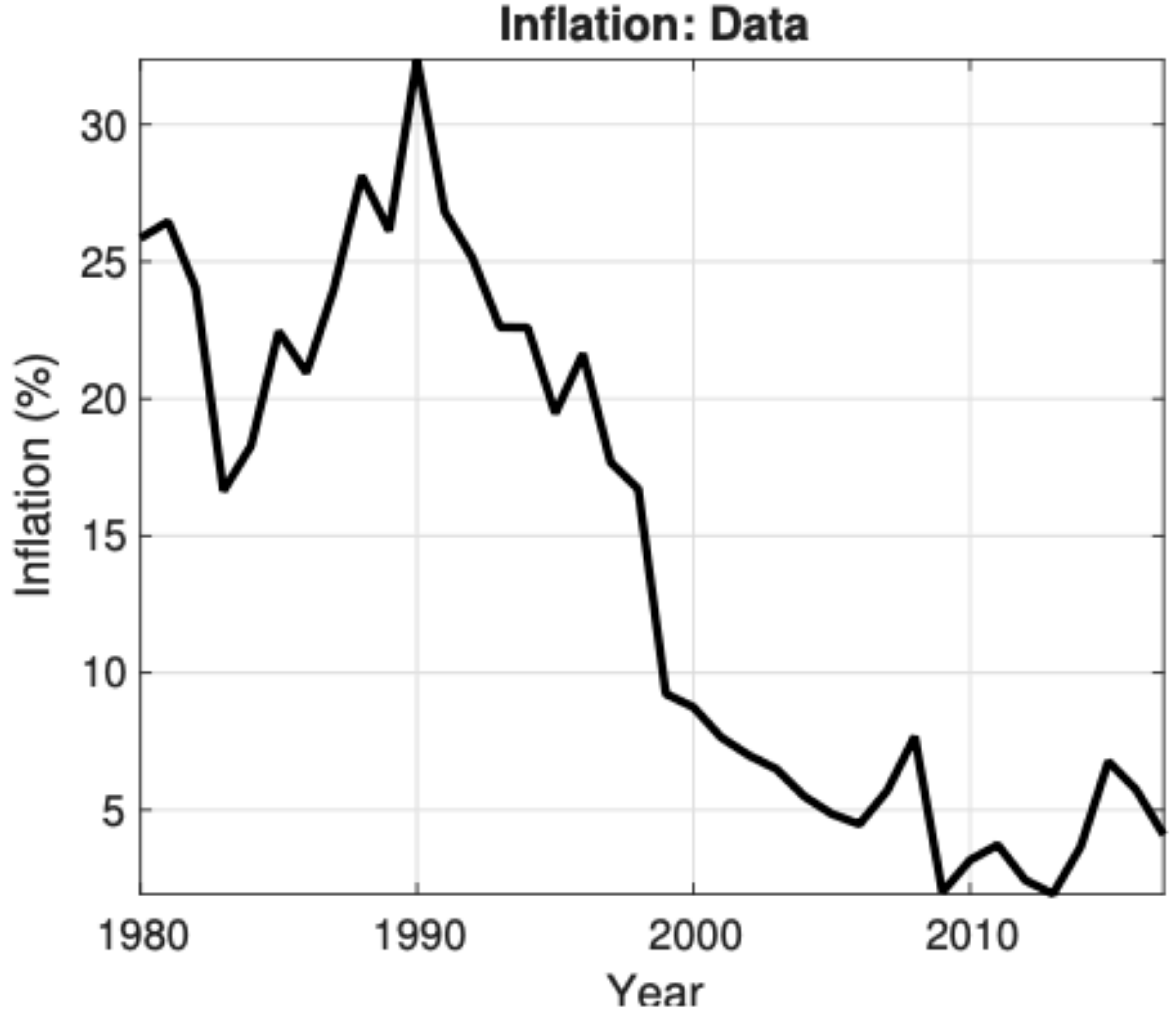
- In Chile disinflation associated with a decrease in public indebtedness

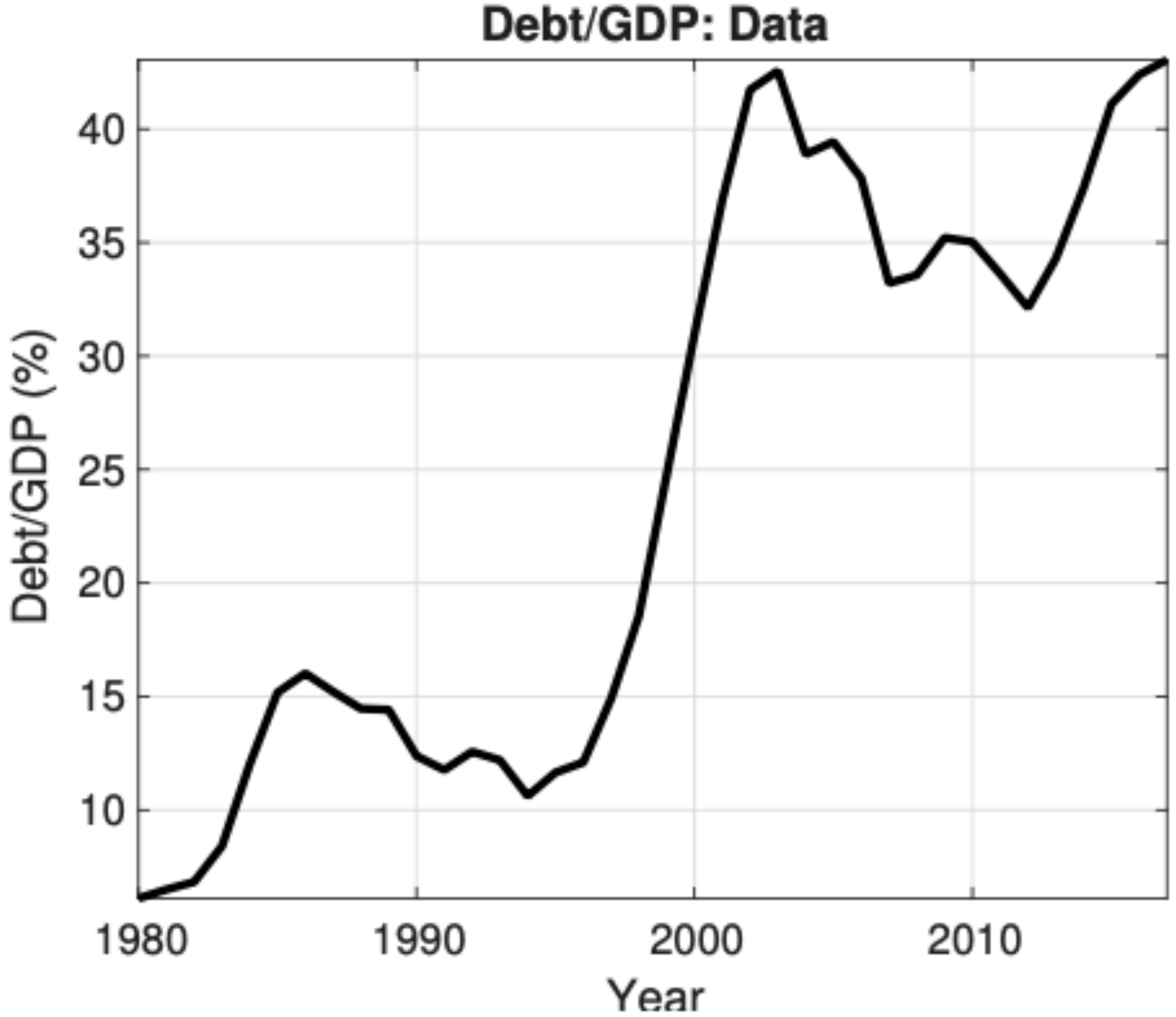




Public debt and inflation

- In Colombia disinflation associated with an increase in public indebtedness

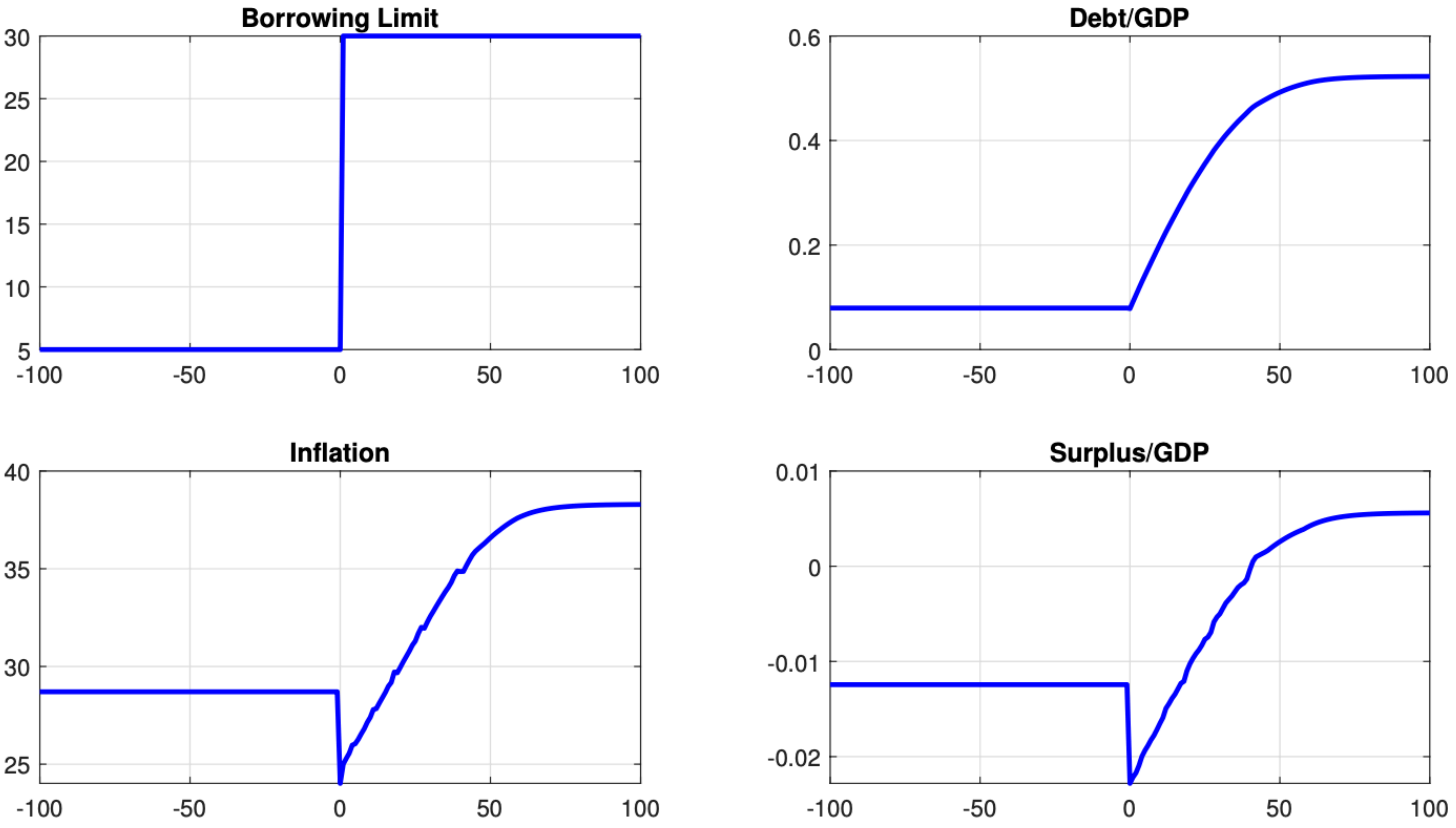




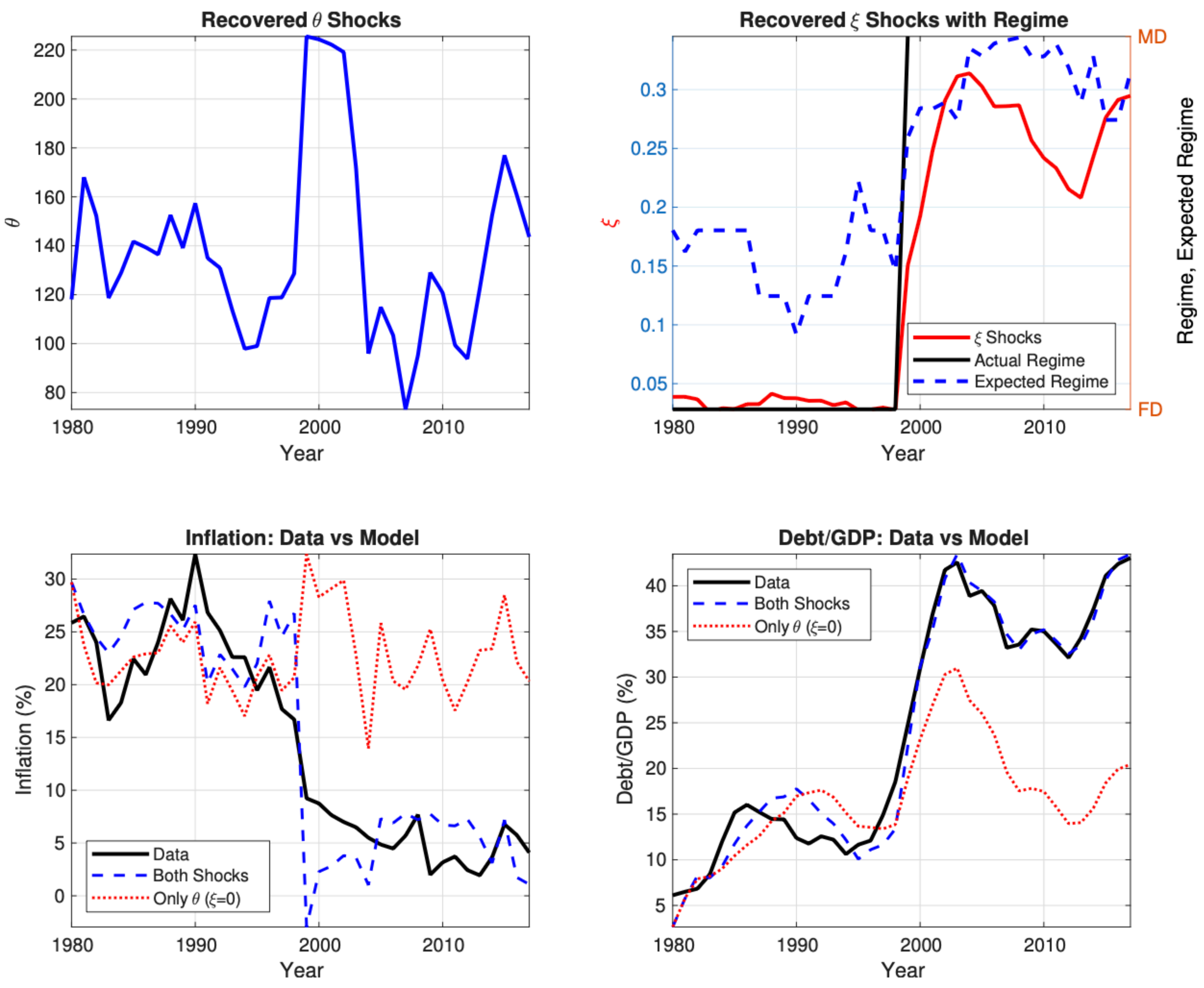
Debt market access and inflation

- **Bocola-Chaumont-Dovis-Kirpalani, "Accounting for Credibility: Monetary-Fiscal Interactions and the Credibility of Central Bank Mandates"**
- We study the interaction between fiscal position and the credibility of a central bank mandate
- Main trade-off
  - Ex-ante incentive to have independent central banks with an inflation-targeting mandate
  - Ex-post, the mandate can be taken away by the government
- Disinflation driven by
  - Fundamentals (fiscal consolidation)
  - Institutional credibility/reputation
- **Credible monetary delegation is a prerequisite for market access**
  - Not the other way around

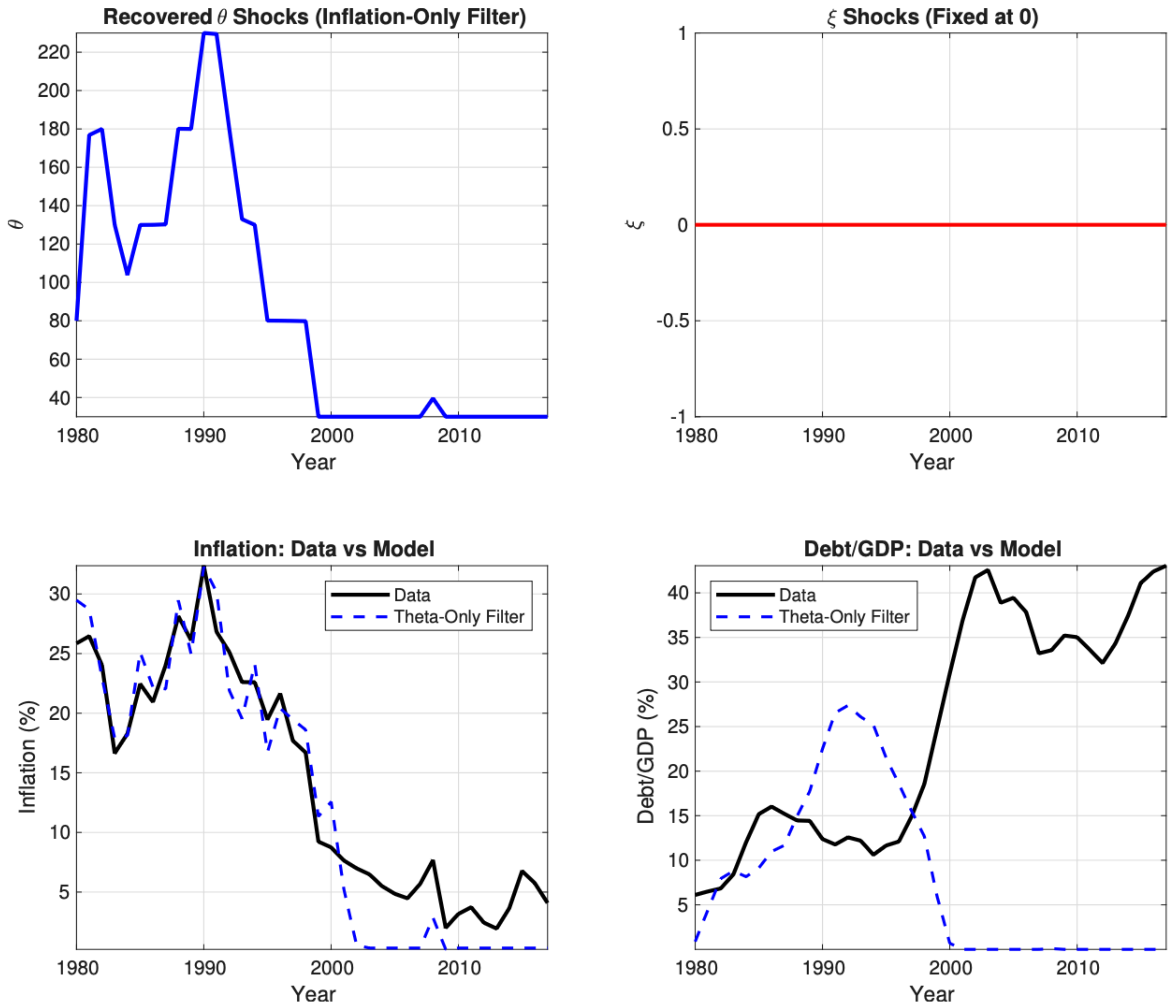
If there is an increase in market access w/out an increase in credibility $\Rightarrow$ inflation eventually is higher



Example: Colombia



Example: Colombia, cont.



Taking stock

- Similar dynamics in
  - US after Volcker
  - Italy in the 1980s after the Bank of Italy's independence
- Credible institutional reforms allowed
  - Independent central banks to keep inflation low and stable
  - Government to issue public debt
- Caveat from Mark's argument: If government is present-biased, access to lots of debt may be an unintended consequence of getting inflation under control
  - Similar to Aguiar-Amador-Farhi-Gopinath

Optimal institutional design

- Limiting debt market access is a *"second-best"* policy
- Set up institutions so that present-bias/special interests, etc., do not take over
  - Examples: Fiscal rules, fiscal councils, central bank mandates
- There is theoretical work on the issue
  - Aguiar-Amador
  - Athey-Atkeson-Kehoe, Amador-Bagwell, Halac-Yared, Dovis-Kirpalani, Dovis-Kirpalani-Sublet
- But need
  - Robustness vs. focus on best equilibrium/mechanism
  - More connection with empirical work

Typical approach

- Study the best mechanism/equilibrium subject to frictions
  - Commitment
  - Present-bias, political economy frictions, etc.
- $\max_{\text{policy}}$ citizens' utility subject to politician incentive constraints
- This delivers prescriptions for optimal institutions
  - Fiscal rules, fiscal councils, central bank's mandates, etc.

Robustness of optimal rules

- But multiplicity is pervasive
  - W/out commitment, good equilibrium is supported by reversion to bad one
    - If gov't is compliant $\Rightarrow$ reward with good continuation value
    - If gov't deviates $\Rightarrow$ "punished" with coordination on bad outcome
- What ensures this coordination?
- Emphasis on robustness
  - Extreme case: policies that maximize value subject to the most adversarial selection

Role of the IMF

- Can the IMF help to achieve the desired outcome?
  - Pro: IMF is a big player, no need to coordinate several private agents
  - Con: Information, democratic representation, …
- Study incentive provisions through
  - Credit markets
    - Reputation for sound policies —> low interest rates, high FDI, etc.
  - Self-imposed fiscal rules
    - Make deviations transparent
  - IMF programs
    - External monitoring

Conclusion

- Extremely interesting and thought-provoking paper
- Raises a critical question: Is the ability to issue public debt a net-negative?
- Little evidence that no is the answer
  - I argue that monetary-fiscal interactions do not help to change the answer
- Questions:
  - Are we missing some channels?
  - How to (credibly and robustly) address the present-bias problem directly?
    - Data and theory