Discussion of: Financial Cycles and Fiscal Cycles Agustín Bénétrix Philip Lane

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These are my own views and do not necessarily represent those of the United Nations or of any of its member states

Florence, June 6, 2011

Outline

- Takeaway and channels
- Identification
- Other stuff

Takeaway

- Prior:
  - Current account deficits increase revenues and thus will lead to an improvement of fiscal outcomes
- The paper finds that current account deficits are associated with:
  - An increase in revenues
  - An even higher increase in spending
- As a consequence, fiscal accounts deteriorate
- Policy implications:
  - The design of fiscal rules should take into consideration the financial cycle
  - Does the end of credit booms bring a double whammy?
    - Banking crisis
    - The fiscal accounts are not as good as we believed

Competing hypotheses

- The findings of the paper are consistent with political economy stories
  - Voracity (Lane and Tornell), Alesina, Campante and Tabellini, Talvi and Vegh
- What about stories that emphasize imperfections in international capital markets?
  - (lack of access during bad times, like in Gavin and Perotti)
- Can we gain some insight by splitting the sample into good and bad times
  - Growth
  - Conditions in the international capital markets

Heterogeneity

- Separating “Normal” from other times
  - Not necessarily crises
  - Large versus small changes in CA
  - More in general, explore nonlinearities
- Testing the political channel:
  - $FISC_{it}=\alpha_i+CYCLE_{it}(\beta+bINST_i)+Z_{it}(\gamma+gINST_i)+\ldots$
- Ability to finance higher deficits:
  - High-debt versus low-debt economies
  - High-rating versus low-rating economies
- Degree of financial openness
  - (*de jure* and *de facto*)

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Identification

- Two endogenous variables:
  - Output (absorption)
  - Current account
- Two instruments:
  - Weighted output of trading partners
  - Oil price*(net oil trade position)
- Weak instrument tests OK
- Sargan test OK

Identification

- …but…
- …do we really believe that oil prices have no *direct* effect on fiscal variables?
  - Oil exporting countries get royalties
  - Oil importing countries tax energy
    - Elasticity?
- Sargan?

Outline

- Takeaway and next steps
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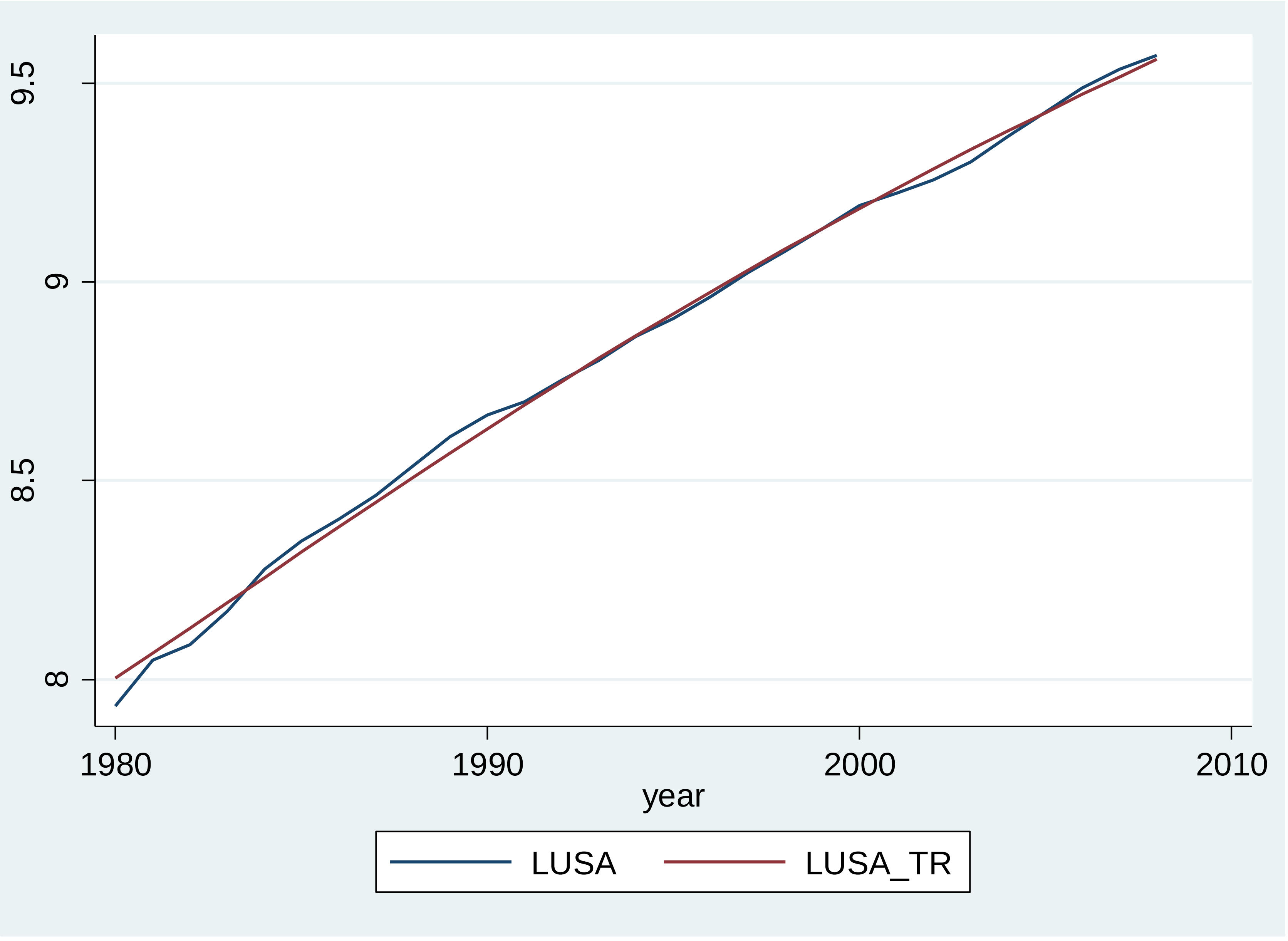
- Other stuff

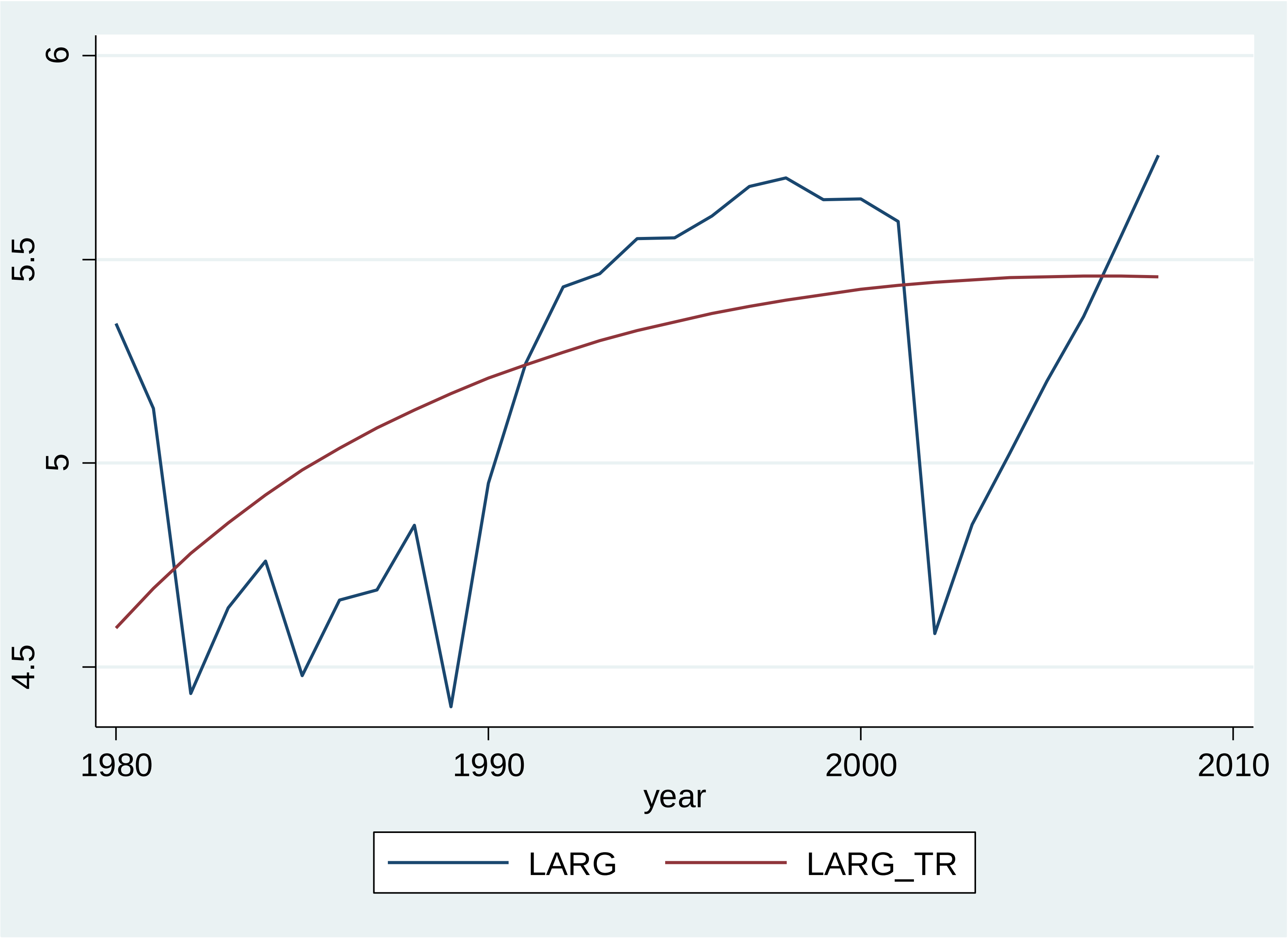
Other stuff

- No procyclicality???
  - Measuring the trend

Trend *versus* actual: USA



Trend *versus* actual: Argentina



Other stuff

- No procyclicality???
  - Measuring the trend
- Balancing the panel
  - Highly unbalanced for EM (on average 13 obs. per country)
    - (maybe drop debt/GDP)
  - It would be nice to have Table 6 for Ems
- Why not using MT interaction for the financial variables?
  - You would only lose 2 degrees of freedom and it would be nice to see of the coefficients are the opposite of EMU like in the case of GDP
  - Also, saying that the coefficient is not significant is not a good excuse for dropping variables.
  - When you interact things, significance tends to depend on the way you decide to interact.