

Discussion: Expenditure Consolidation and Sovereign Debt Restructurings: Front- or Back-loaded

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World Bank

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Introduction

Important question: which are the implications of different types of restructuring on fiscal policy? Aggregate? and components?

Main Contribution: document interesting set of facts on types of restructurings and fiscal policy...positive model to speak to these facts...predictions in line with the data

Discussion:

- summary and comments on the facts
- main intuition for choices, comments
- comments: modeling choices, alternative mechanisms

Overall...important contribution, nice to read, interesting results

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Empirical Analysis: Definitions

Def 1. Expenditure consolidation. Measure: $cab_t = \frac{CAB_t}{GDP_t}$. Also use GDP_{t-1} . More than 1.5 percent. Two sequential years least 1.25 percent a year.

Def 2. Two types of consolidations...**Front-loaded**...occurs prior to the start of restructuring.
Back-loaded...occurs after the start of restructuring

Comment. Calculation of cab...

- cab: remove one off factors...remove business cycles...remove other cycles and factors...
- example: output composition...asset prices...wealth effects...**useful to discuss.**

Comment. Fiscal consolidation as an impulse response.

- Define $\hat{g}_t = cab_t |_{policy} - cab_t |_{baseline}$
- front-loaded \hat{g}_t jumps and then monotonically decreases
- back-loaded \hat{g}_t peaks at some point in the future and decays...
- Silva (2022), optimal fiscal consolidation front load VAT and payroll taxes...

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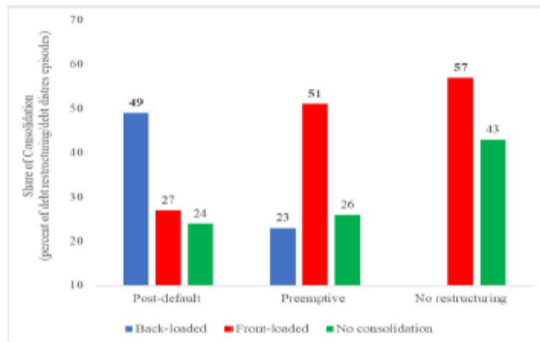
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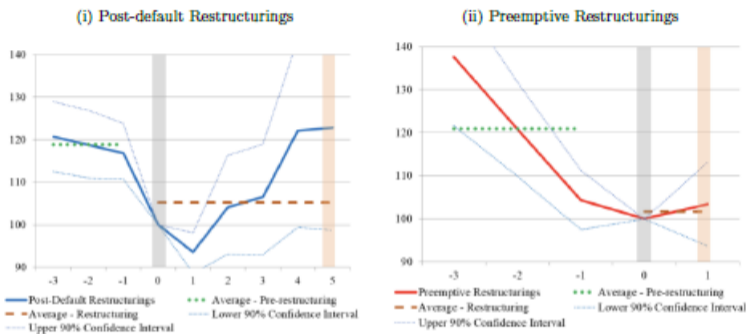
Empirical Analysis: Facts I



Fact 1: Post default: back loaded. **Preemptive:** front loading.

Comment. Related to the previous point. Is there something else about the *path* of adjustment? Common in IMF programs, not only the size, but also the path over time...

Empirical Analysis: Facts II

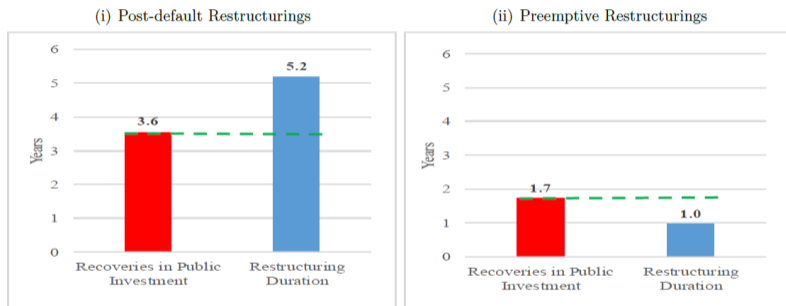


Facts 2 and 3: **Post default:** investment drops 1 year before or at the same time. **Preemptive:** investment drops much before restructuring.

Comment. Is the behavior of investment caused by the type of restructuring? Ideally, identification. Understand data limitations. One option is going deeper into some cases.

Empirical Analysis: Facts III

Figure 3: Recoveries in Public Investment and Duration of Restructurings



Facts 4: Post default: slower recovery, longer restructuring. Preemptive: opposite.
Comment. Again...are these countries fundamentally different (ultimate drivers)?

Other Comments on Empirical Analysis

Cyc. adjust balance is a summary measure...

- Revenue. Direct: Personal and Corporate. Indirect Taxes. Social Security.
- Spending. Compensation. Use of goods and services. Interest. Subsidies. Investment.
- **Where the consolidation is coming from post and pre default restructurings?** Stickiness.

When we think about **fiscal multipliers** in EM's, LICs, and even AE

- exchange rate regime and/or monetary policy rule
- inequality and financial development: the marginal propensities to consume
- automatic stabilizers fiscal rules...degree of openness of the economy
- **Model is real and one good...so fixed exchange rate regimes...sample size is a challenge to go into the details. Which subset of these episodes are we focusing on?** Post crisis dynamics matter.

Presumably **different types of crises**...which demand different responses..

- Crises due to fundamentals Arellano (2008)...vs self-fulfilling debt crises...Calvo (1988) Cole Kehoe (2000) Bocola Dovic (2019). Extend maturity vs shorten maturity.
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Small open economy. Arellano (2008). Capital accumulation. Gordon Guerron Quintana (2018)

$$y_t = \mathbf{a}_t (l_t)^{\alpha_l} (k_t^g)^{\alpha_k} (k_t^p)^{1-\alpha_l-\alpha_k}$$

Debt. Short term debt. Not state contingent.

Cost of default / restructuring...

- Preemptive, drop λ_p . Larger drop default λ_d . Asonuma Trebesch (2016).
- Outside debt market negotiating or arrears. Preemptive: easy comeback.

Bargaining. Alternating offers Merlo Wilson (1995). Follows Asonuma Trebesch (2016).

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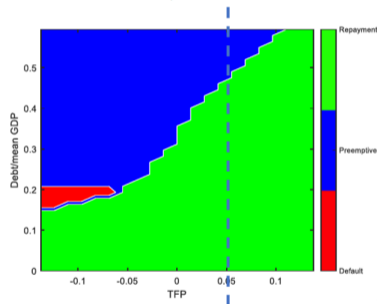
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Case 1. High TFP, low and high debt. Similar intuition as in Arellano (2008). Low debt. Repay. High debt. TFP is high, and no need to incur in costly to default, preemptively restructure.

(iii) Choice for Repayment, Preemptive and Default/Post-default

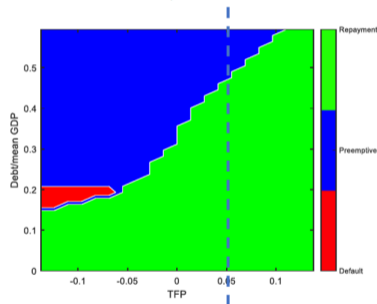


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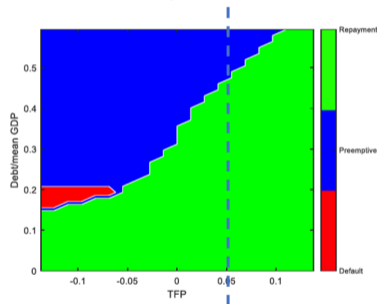


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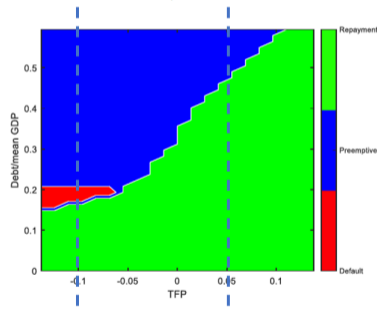


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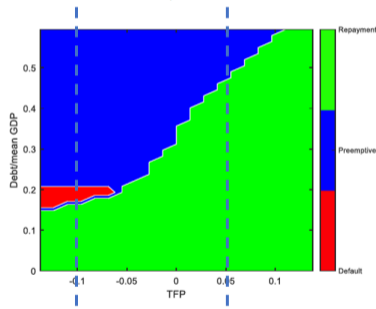


Comment. Upper left quadrant: with the highest Debt/GDP ratios and short term debt choose preemptive restructuring? Correl. low capacity... Modeling choice: Preemptive a_{t-1} , default a_t .

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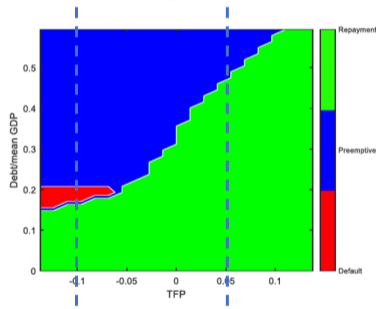


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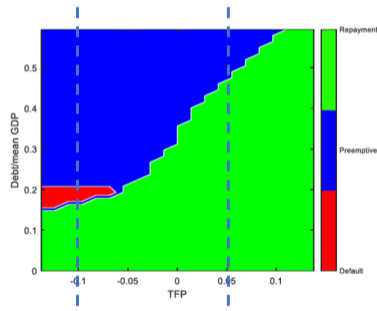


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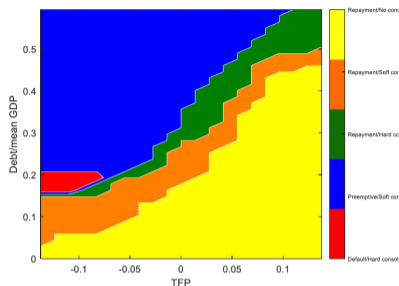
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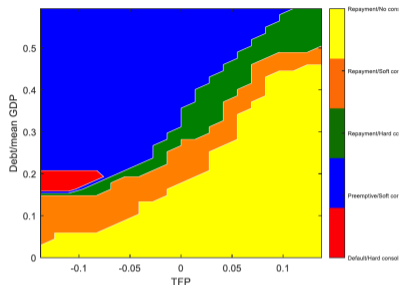
Choice of k' and g

$$\int_A V_k(b_{t+1}, k_{t+1}^g, 0, a_{t+1}) d\mu(a_{t+1} | a_t) = \omega v'(g_t) [1 + \text{Adjustment}]$$

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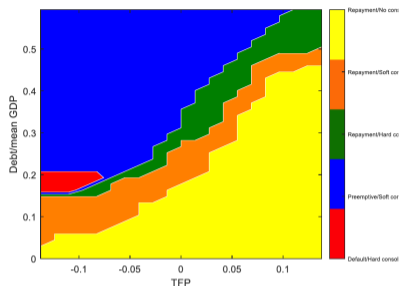
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Comments: Modeling Choices

Long term debt. Hatchondo Martinez (2008). Does not seem to be material for the qualitative analysis. Matters for quantitative analysis. Discount factor is low.. $\beta = 0.8$ and moments on average spreads and volatility are far from the data.

Maturity Management. This will affect gross financing needs. And thus, free up resources for spending. Also, maturity responds differently to different types of crisis. Self fulfilling extend. Fundamentals shrink.

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Other mechanisms for a front-loaded fiscal consolidation before a restructuring?

Risk sharing. Hidden income or Moral Hazard + Limited Commitment.

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- Atkeson (1991). During bad times as well, since they are informative of low effort
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- Constructing an interesting data-set. Uncover new facts.
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Complete agenda on restructurings Asonuma Trebesch (2016), Asonuma Joo (2020).

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