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

Ugo Panizza
UNCTAD
Graduate Institute of International and Development Studies

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:
  – $FISC_{it} = \alpha_i + CYCLE_{it}(\beta + bINST_i) + Z_{it}(\gamma + gINST_i) + ...$

• 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)
Outline

• Takeaway and channels
• Identification
• Other stuff
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
• Identification
• 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 if 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.