Comments on Carlos Esquivel and Agustin Samano's "Expansionary Fiscal Consolidation Under Sovereign Risk"

By Diwa C Guinigundo
Former Deputy Governor, Bangko Sentral ng Pilipinas
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E-S PAPER INTERESTING: FISCAL CONSOLIDATION CAN BE EXPANSIONARY

- Fiscal consolidation = fiscal contraction, normally
- No-no during election!
- Some say: With firm fiscal policy, tax increases more recessionary than spending cuts
- Pandemic made debt accumulation unavoidable, an issue due to the need to sustain economic recovery

E-S PAPER INTERESTING: FISCAL CONSOLIDATION CAN BE EXPANSIONARY

- Emerging markets, including the Philippines, issue is access to capital markets
- But pandemic-induced debt accumulation is big hurdle, could escalate borrowing cost
- Fiscal rules = debt cap, could limit rapid debt accumulation, enhance access to capital and augment I and Y?
- E-S: Yes, appropriate fiscal rules can inform market of public policy and commitment, motivate higher confidence in growth path
- With fiscal rules promising fiscal responsibility, gains in welfare expected

A QUICK FOCUS ON THE PHILIPPINES

- Rapid accumulation of public debt due to pandemic
- PIDS paper (May 2022) argues our indebtedness less serious than in 1980s and 1990s

A QUICK FOCUS ON THE PHILIPPINES

- Using IMF debt sustainability analysis, PIDS found debt to GDP ratio to remain elevated in the medium term
- Fiscal gap analysis suggests that restoring debt to GDP ratio to pre-pandemic level of 40% may be difficult to do in 10 years without significant fiscal tightening.

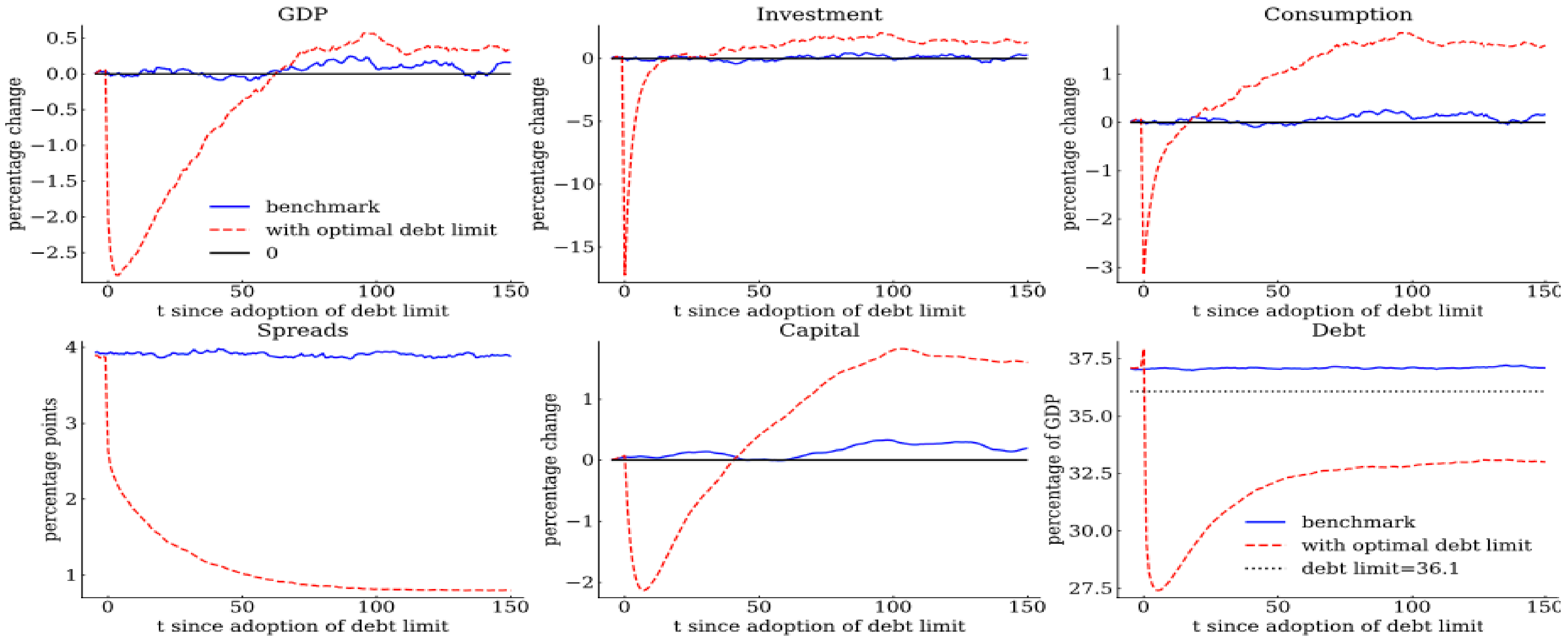
BACK TO E-S PAPER…

- Optimal fiscal rule, or debt limit, can generate econ expansion
  - *Can lead to more positive market sentiment*
  - *Can lower sovereign risk, spreads*
  - *Can motivate higher capital returns*
  - *All based on negative correlation between debt rules and sovereign debt spreads, lower debt spreads motivate higher private investment*

Back to E-S Paper…

- Most interesting point: ***"fiscal rules emerge as an efficient mechanism through which citizens provide incentives to the government to behave according to their best interest."***
- Fiscal rules
  - *Limits possibility of debt dilution by future governments*
  - *Lowers default and distortions to private investment*

Figure 2: Average transition paths



Each line corresponds to the average of 10,000 paths. The starting point of each path is taken from simulating the economy for 1,001 periods and dropping the first 1,000 to remove the influence of initial conditions.

Back to E-S Paper…

- Another key point: After fiscal consolidation, contraction much bigger but recovery more rapid in both consumption and investment
- Expectations about future fiscal policy on spreads critical
  - *Last year's roll out of MTFF can anchor market expectations, confidence in NG's effort to restore pre-pandemic debt dynamics and growth*
  - *Other debt sustainability risks*
    - Mandanas-Garcia petition: higher allocation to local govt
    - Natural calamities
    - Military and uniformed personnel pension
    - Philhealth net losses
    - Aggregate demand risks

SOME FINAL THOUGHTS

- Stochastic complement to proposition in our book "Economic Adjustment and Growth: Theory and Practice": Capital accumulation financed by domestic savings, foreign borrowing
- The higher the debt stock, the higher the probability of default
- Risk premium up, cost of foreign borrowing up
- Fiscal consolidation, by reducing default risk and sustain foreign borrowing contributes to higher I, higher Y
- How to address issue of micro-optimization of econ agents in macroeconomic context
- Rational versus adaptive expectations?