

A Goldilocks Theory of Fiscal Policy by Mian, Straub and Sufi

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Background

- What is a sustainable debt/output ratio b ?
- We know answer depends on
 - ▶ Public deficit z
 - ▶ Interest rate (nominal) R
 - ▶ Growth rate (nominal) G
- From government budget constraint:

$$\dot{b} = z(b) + [R(b) - G(b)] \cdot b$$

Note: if

- ▶ $R(b) > G(b)$: debt servicing requires public resources
- ▶ $R(b) < G(b)$: debt is a source of resources for government

The paper in a nutshell

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- Potential stories for $G'(b)$
 - ▶ $G'(b) < 0$: crowding-out (Reinhart-Rogoff 2010), debt overhang
 - ▶ $G'(b) > 0$: liquidity provision (Woodford 1990), infrastructure (IMF 2020)
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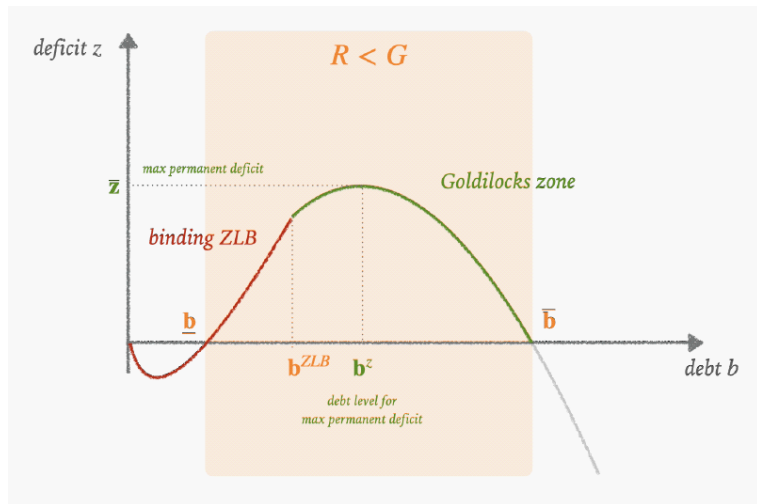
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- **This paper:** Nominal rigidities (ZLB) plus convenience yield of public debt

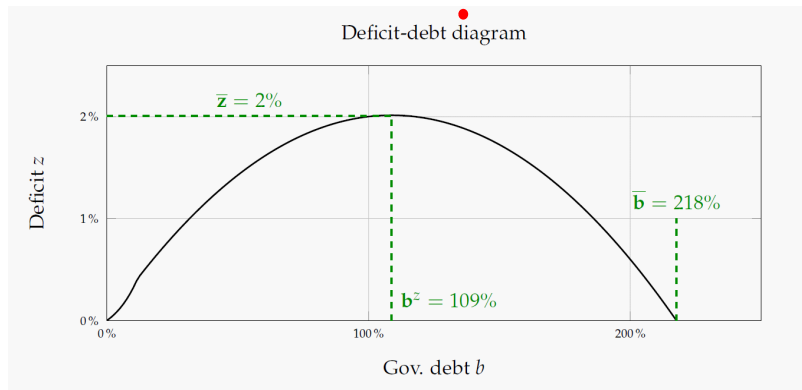
At ZLB ($R(b) = 0$): $R'(b) = 0$ and $G'(b) > 0$

Outside of ZLB ($R(b) > 0$): $R'(b) > 0$ and $G'(b) = 0$

Debt-deficit diagram

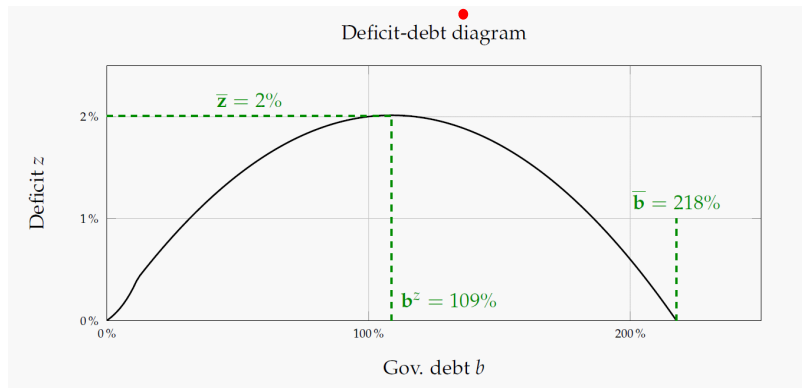


Debt-deficit diagram for specific economies: US



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- In paper: Japan, Italy, Germany

General reaction

- Welcome contribution to debate on debt sustainability
 - ▶ Take general, well-known insight
 - ▶ Cast it within specific model (nominal rigidities+convenience yield)
 - ▶ “Calibration” to US, other countries
- My (personal) quibble with the model
 - ▶ How can we be at ZLB indefinitely, with permanent effects on output?
 - ▶ But this is not very relevant for the authors’ main results
 - ▶ Stick to general comments

Stress insights: convenience yield matters

- Traditional debt sustainability analysis

$$z(b) + [R - G] \cdot b = 0$$

- In authors' US calibration:

- ▶ $G - R = 2\%$ (pre-pandemic, suppose constant)
- ▶ b increases from 100% to 126% due to pandemic
- ▶ Maximum deficit consistent with debt sustainability?
 - ★ If convenience yield constant: $z = 2.52$
 - ★ If convenience yield adjusts as in data: $z = 1.97$

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- Yet, US debt seems unsustainable given deficit projections (despite $R < G$)!
 - ▶ Is a massive fiscal adjustment looming?

International dimension

- Paper contains interesting discussions of:
 - ▶ Domestic vs. foreign currency debt
 - ▶ Currency union
- Throughout, convenience yield depends only on local debt b
- This may not be the case in practice
- E.g. in euro area, convenience yield affected by euro-wide supply of debt
 - ▶ Fiscal space of any one country affected by others' supply of debt (b^*)
 - ▶ b^* may create or reduce fiscal space depending on whether economy is at ZLB
 - ▶ Scope for coordination (see Broner et al. (2021) for related analysis)
- Individual countries may not supply globally optimal amount of debt (e.g. Bolton and Jeanne 2011)

Taking a step back

- Broad view: world with large demand for (safe) assets ($R < G$)
 - ▶ Rents for whoever can supply them
- Private sector (bubbles)
 - ▶ But they can burst!
- Public sector (debt)
 - ▶ **This paper**: watch out for convenience yield
 - ▶ More broadly: sovereign risk
- How should the global supply of safe assets be structured?