Discussion of Farhi, Gopinath and Itskhoki's "Fiscal Devaluations"

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The FGI paper in a nutshell

- Two regimes:
  1) Constant fiscal variables, exogenous path for the nominal exchange rate.
  2) Constant nominal exchange rate, adjustable fiscal variables.
- **Question**: can we replicate 1) with 2)?
- Key assumptions:
  - nominal rigidities → non-neutrality of nominal exchange rate policies
  - staggering → real effects of price and wage paths

Unit Labor Costs in the Euro Area

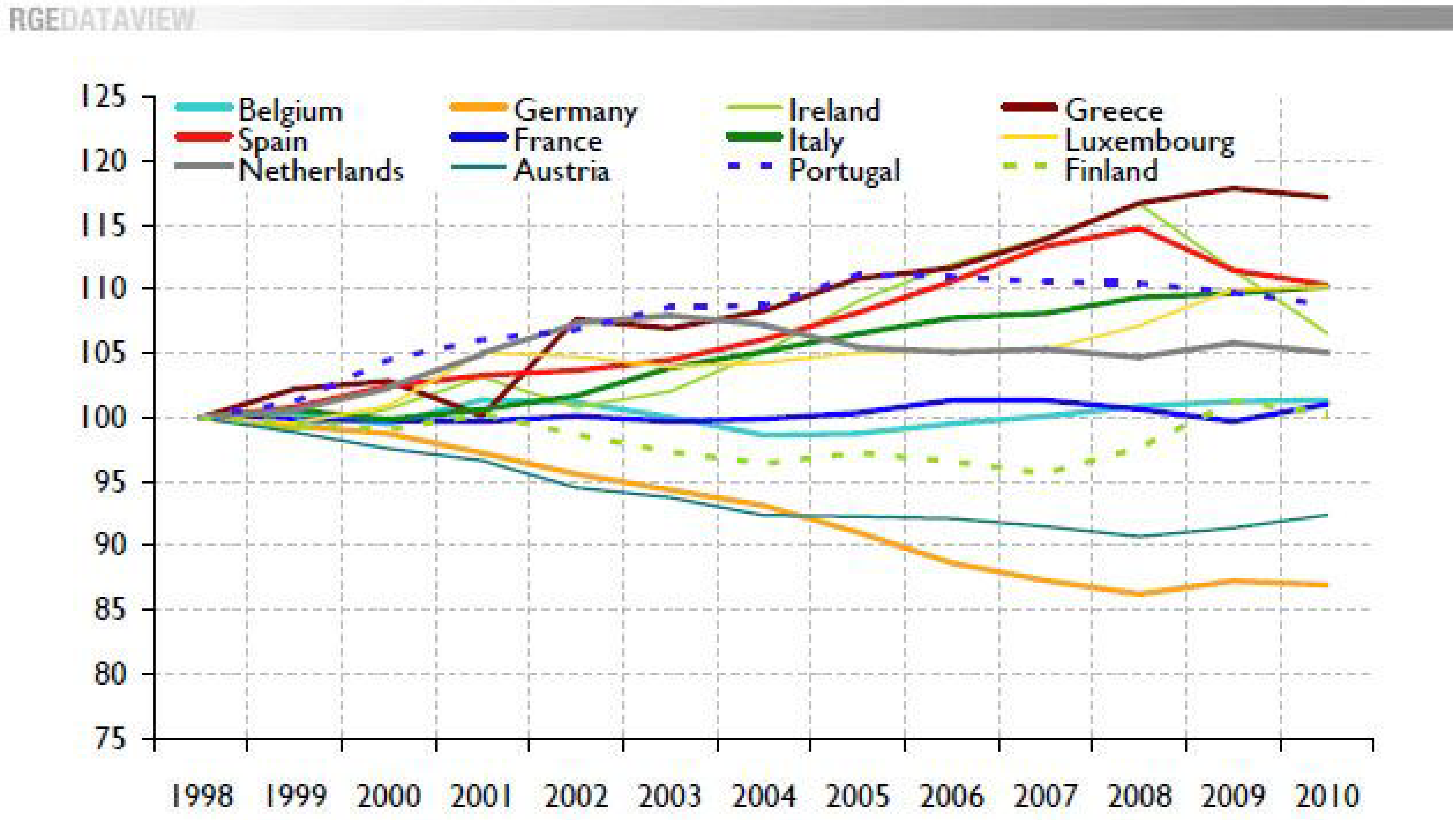
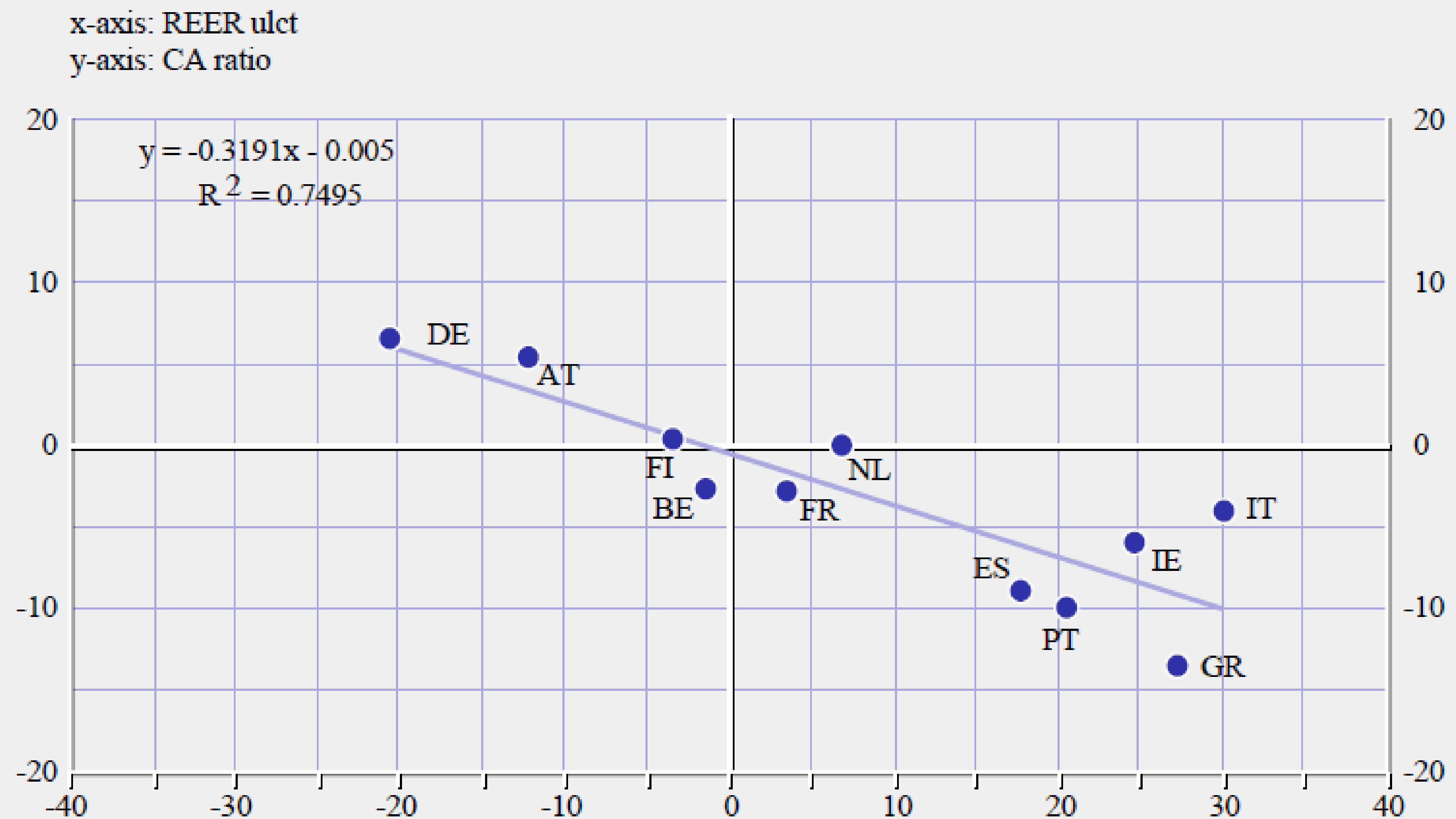


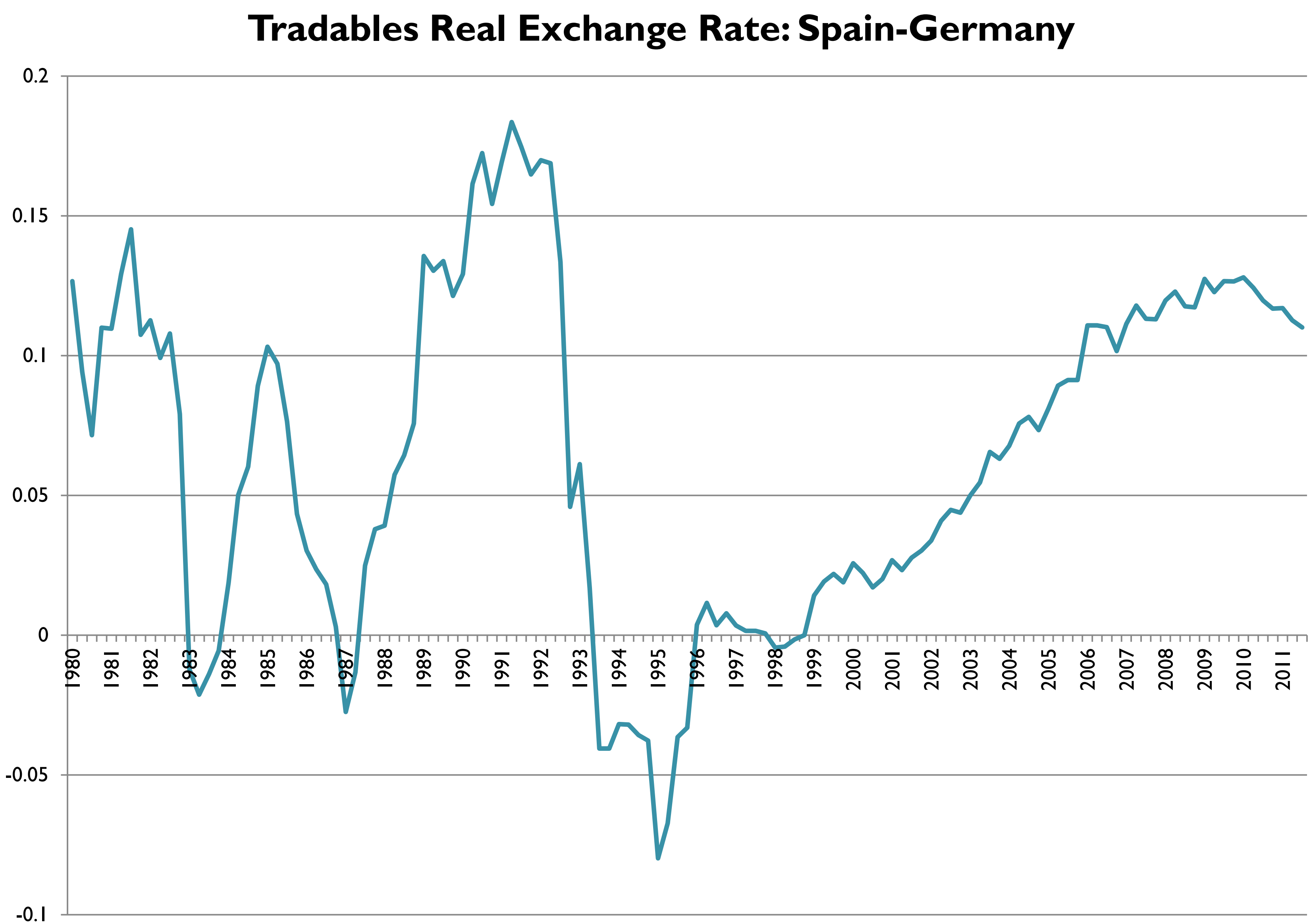
Chart 13 The real exchange rate and the current account, 1998-2008

(in percentages)



Sources: Eurostat, OECD and ECB calculations.

Source: Mongelli and Wyplosz (2009)


Tradables Real Exchange Rate: Spain-Germany
0.2
0.15
0.1
0.05
0
-0.05
-0.1
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
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1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011

Comments (I)

- Careful analysis
  - alternative fiscal devaluation strategies
    - trade distortions-based FD
    - VAT + payroll taxes-based FD
  - variety of environments
    - Complete vs. incomplete asset markets
    - Unanticipated devaluations
    - Currency union (single central bank)
    - Partial pass-through
- Main result: replication generally possible, as long as enough fiscal tools are mobilized.

Comments (II)

- Main novel results
  - replication of real exchange rate: role of consumption and labor income taxes (irrelevant for unanticipated devaluations).
  - replication of foreign-currency payoffs: role of haircuts
  - government revenue neutrality
  - conditions for replication in a currency union
  - …

Comments (III)

- Replication result: Shall we be surprised? Large toolkit:
    - tariffs, export subsidies
    - VAT , payroll taxes
    - consumption and income taxes
    - haircuts
- Replication result: Why is it interesting?
  - devaluation optimal under special assumptions
  - fiscal tools should be more powerful:
    - exchange rate policy = "constrained" fiscal policy

Comments (IV)

- Historical devaluations: often large, one-time.

  → large real wage adjustment, conditional on nominal wage

  →Calvo assumption questionable?

- Payroll taxes, in practice: "more than a tax"

- Missing case: anticipated *nominal* devaluations within a currency union.

- Evidence on FD: de Mooij and Keen (2012)