Discussion of

Managing Credit Booms and Busts: A Pigouvian Taxation Approach

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- This paper presents a theory of fluctuations in consumption due to credit markets imperfections.

- The authors emphasize the failure of consumers to internalize their savings decisions on asset prices as a source of the fluctuations. They argue in favor of a "Pigouvian tax."

- They provide a quantitative assessment of the theory:
  - $\tau \approx 0.5\%$ of outstanding debt.

- I have enjoyed reading the paper very much!

- In my discussion:
  - Illustrate the main ideas of the paper;
  - Propose a different interpretation;
  - In the light of this, discuss policy implications.

I. The main idea

- **Key ingredients:**
  - Citizens are endowed with a partially tradable asset:
    - Only locals can own it. Its price is p_t .
    - It generates a stochastic flow of income y_t .
  - Imperfect credit market require collateral: $debt \leq \phi p_t$

- **Two observations:**
  - We have a feedback effect:

$$c \downarrow \rightarrow p \downarrow \rightarrow debt \downarrow \rightarrow c \downarrow$$

Credit imperfections amplify fluctuations in c.

- Agents are price-takers. Agent ***i*** does not internalize that:

$$s^{i}_{t} \downarrow \rightarrow Ec^{i}_{t+1} \downarrow \rightarrow Ep_{t} \downarrow \rightarrow Ec^{j}_{t+1} \downarrow$$

- The authors conclude: we need a Pigouvian tax that forces the consumers internalize this "*externality*."

II. Is the externality the problem?

– A price externality is present even in a standard unconstrained Pareto efficient competitive equilibrium.
– Here, price changes have a first order effect on welfare because the allocation is inefficient when the collateral constraint is binding.

- The planner smoothes the cost of the distortion by taxing in good times and subsidizing consumption in bad times.

- There is however no need to tax private debt (which may be very distortive both on consumption and on investment).

- A lump sum tax on income may be superior, and always be used:
  - It does not fix the "price externality"
  - By smoothing asset prices, it fixes the cause of the problem.

  - Even when income taxation is distortionary, it is necessary in a constrained optimum.

- Bottom line: *we can not discuss welfare implications of the Pigouvian tax if we ignore the rest of fiscal policy. This is a problem of public debt management.*

III. The calibration

- The authors do a good job in exploring the quantitative implications of the model:
  - Without the explicit consideration of a richer policy mix, the argument for a "Pigouvian tax" is not persuasive.
  - Partial equilibrium assumption that $\beta R<1$ is problematic.

- The theoretical model however is a good platform to study the issues that I have tried to highlight in this discussion.