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 $\text{debt} \leq \phi p_t$

• Two observations:
  – We have a feedback effect:
    \[
    c \downarrow \rightarrow p \downarrow \rightarrow \text{debt} \downarrow \rightarrow c \downarrow
    \]
    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.