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Discussion on

Revisiting Overborrowing and its Policy Implications

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Views from an outsider

Main paper's contributions

- addresses and provides insights on hot topic: macro-prudential policy vs. monetary and fiscal policy responses to financial crises
  - optimal amount of borrowing under constraint
  - role of ex-ante & ex-post policy
  - maybe related to next financial crisis?
- methodological contribution
  - occasionally binding constraint

Model central feature

- **external borrowing constraint, function of domestic aggregate GDP:**

$$B \geq -\theta \, GDP$$

  - **occasionally binding: affects behavior in normal times**
  - **externalities, with net effect depending on model & parameters**
  - **role for government**

Findings

- considering production economy (i.e. allowing for additional externalities), relative to endowment economy, potentially changes policy conclusions
    - potential for underborrowing instead of overborrowing
- in terms of welfare, case for ex-ante (macro-prudential, taxing debt) policy is not clear; clear cut rationale for ex-post interventions
- policy implications highly model dependant

Issues / suggestions for extensions

1. tightness of borrowing constraint is exogenous & constant

$$B \geq -\theta \, GDP$$

However, θ could be stochastic / depend on:

- foreign shocks (risk appetite): risk premium variations
- foreign (monetary) policy (domestic-foreign interest rate spread): persistent search for yield might affect borrowing & optimal policy response foreign inflows
- current domestic (monetary) policy (relative to foreign)
- amount of borrowing itself (risk premium)
- anticipated post-crisis domestic policy

→ would be interesting to assess effects of stochastic and/or endogenous elements affecting tightness of constraint, and how this affect optimal policy

Issues / suggestions for extensions

2. when comparing ex-ante/ex-post policy, assumes that government can raise output in crisis time; how (distortions) and how fast?
   - this would limit potential gains of ex-post policy
   - main contribution of paper: externalities with occasionally binding borrowing constraint can lead to under- or over-borrowing, rather than policy implications

Issues / suggestions for extensions

3. how well do key model variables match empirical facts before (i.e. business cycle) and after crisis episodes? What are implications of optimal policy for business cycles?
   - need to take model closer to data before drawing policy conclusions

Conclusions

- **interesting and important paper**
- **potentially useful framework to understand the next financial & economic crisis…**