Discussion

Exchange Controls As A Fiscal Instrument

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This Paper

- **Motivation**
  - Dual exchange rates/exchange control regimes
    Argentina: "Cepo cambiario" $\Rightarrow$ calibration
  - Tax on net exports

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- **This paper**
  - Interesting question
  - Elegant modeling
  - Careful quantification

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- Other interesting results
  1. Exchange rate controls require both legal and illegal trade
  2. Strong (arbitrage) force to overstate official imports
- There is a lot in the paper

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- No access to financial markets

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- Standard (representative) household side

$$\sum_{t=0}^{\infty} \beta^t U\left(c_t, h_t\right)$$

$$[1+\underbrace{s\left(v_t\right)}_{\substack{\text{transaction}\\ \text{cost}}}]c_t+\frac{i_t}{1+i_t}m_t+\frac{a_t}{1+i_t}=w_t h_t+\tau_t+\underbrace{\phi_t}_{\text{profit}}+\frac{a_{t-1}}{1+\pi_t}$$

- Money Demand + Consumption/Leisure + Euler

Model: Firms

- Economic profits: non-tradable

$$\phi_t^e = \underbrace{F\left(h_t, q_t^n\right)}_{\substack{\text{non-tradable} \\ \text{output}}} - w_t h_t + \frac{\mathcal{E}_t}{P_t}\left(\qquad\qquad - \left(q_t^n + \quad\right)\right)$$

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- where

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Mechanism

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- To guarantee $s_t > 0$
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  - $p_t^x x_t^o - q_t^o > 0$ (positive net *official* exports)

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- Firm's have incentives to
  - understate official exports
  - overstate official imports $\Rightarrow$ rationed
    $q_t^o \leq \bar{q}_t^o = (1 - \rho_t)\, p_t^x x_t^o$ (ensures positive fiscal revenue)

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- Exchange controls (γ_t, ρ_t)
  - can generate revenue
  - reduce welfare

Ramsey Policy

- Standard + Timeless Ramsey problems
- Choose to maximize welfare
  1. γ_t (official exchange rate)
  2. ρ_t (rationing)
  3. i_t (interest rate)
- subject to 1 implementability condition

  intertemporal gov't budget constraint

  given external prices (p_t^x and $i_t^\star$) and τ_t (fiscal need)
- Benchmarks
  - No exchange rate controls
  - Minimal inflation

Comments/Remarks

1. **Different angle from *corrective* role of exchange rates**
   - Prominent existing work
     - Sudden stops, macroprudential policy, pecuniary externalities, AD externalities, etc.
     - Capital controls
   - This paper $\Rightarrow$ Friedman Rule tradition

     Schmitt-Grohé/Uribe 2011: "Optimal Rate of Inflation" Handbook of Monetary Economics
   - Correcting distortions vs. Minimizing distortions (hitting revenue target)
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- Maybe useful to integrate both views?
  - "Double dividend"
- "Cepo cambiario" seems driven by reserve management
  - Nontrivial interactions
  - Exchange control on imports $\neq 0 \Rightarrow$ does this mean that exchange controls are not designed to maximize revenue?

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2. **Primary deficit taken as given ("chronic fiscal deficits")**
   - Friedman rule is ruled out
   - What if the government had (distortionary) labor taxes?
   - *Distortionary taxes* vs. Inflation vs. Exchange controls
   - Maybe not for Argentina... but conceptually

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   - Aggregate factor efficiency (h_t)
   - Cross-sectional input efficiency (non-tradable vs. exports)
     Language from: Welfare Accounting, Davila/Schaab 2023
   - Quantification?
   - Writing variables as shares may help
     - e.g. smuggled/official shares + level of imports
   - Useful to compare to a no-deficit first-best

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4. **Can richer production structure impact the results?**
   - Importance of importers vs. exporters
   - Similar with household side heterogeneity

Comments/Remarks

5. **Key calibration inputs**
   - Money demand (estimated) $m = c\left[\frac{A}{D} - \frac{1}{D}\left(\frac{i}{D(1+i)}\right)^{\frac{1}{B}}\right]$
     - Strong currency substitution can change policy prescription
   - Evasion $C(z, \kappa) = \frac{\kappa}{2}z^2$
     - Easy evasion makes controls ineffective
     - Current costs of evasion do not depend on exchange rate gap γ_t directly

Conclusion

- Very interesting analysis of exchange controls as fiscal tool
- Clear normative prescriptions
- Scope to do more work on this area!