The Twin Budget and Trade Balances

Lectura: International Monetary Fund | September 2011 Chapter 4.

Extracto:

“The implications of fiscal consolidation for output and came to some sobering conclusions. It found that fiscal consolidation typically reduces output and raises unemployment in the short term. In addition, consolidation is likely to be more painful if it occurs simultaneously across many economies and if monetary policy is not in a position to offset the negative effects on economic activity.

This chapter continues this research agenda, this time focusing on a different question: What implications will fiscal adjustment in various economies have for their external balances? In economies with twin fiscal and external deficits, such as the United States and some economies in the euro area, policymakers may be hoping that fiscal consolidation that addresses public debt sustainability concerns will also help bring down large external deficits. On the other hand, economies with large external surpluses, such as China, Germany, and Japan, may be concerned that fiscal consolidation will exacerbate their surpluses.

We attempt to shed light on this issue by addressing the following questions:

- How much does public sector adjustment affect external adjustment? This is closely related to the famous twin deficits hypothesis—the notion that a change in an economy’s fiscal balance leads to a change in the same direction in its current account balance.
- In what ways does fiscal adjustment influence the process of external adjustment? Is it simply a matter of reduced public sector demand resulting in lower imports, or is there more to it? What happens to exports, the real exchange rate, and private saving and investment?
In the literature survey by Abbas and others (2011), a majority of studies find that a 1 percent of GDP fiscal consolidation improves the current account balance by 0.1 to 0.4 percent of GDP.

The main findings of the chapter are the following:

- Fiscal policy has a substantial and long-lasting effect on external balances. A fiscal consolidation of 1 percent of GDP results in an improvement in the current account of over a half percent of GDP within two years—an effect larger than found in most other studies using conventional approaches—and this persists into the medium term.
- The improvement in the current account following a fiscal consolidation comes not only through lower import volumes resulting from a decline in domestic demand but also from an increase in export volumes as a result of a weaker domestic currency.
- The current account adjustment is just as large when the nominal exchange rate is fixed or when monetary policy is constrained, but it is more painful—there is a sharper contraction in economic activity, and real exchange rate depreciation over the medium term occurs through a compression of domestic wages and prices, a process.
- Fiscal consolidations synchronized across a number of economies shrink any improvements in the current accounts because everyone’s current account cannot rise at the same time. What matters is how much consolidation an economy undertakes relative to other economies.

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Y Eurostat

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B. Analice gráficamente y describa la relación existente entre reducción (consolidación) déficit público y déficit exterior tanto en el corto plazo (tipos de cambio fijos) como el medio plazo. ¿El modelo visto en clase resulta acorde con lo descrito en el texto del FMI?

C. Comente el párrafo “Fiscal consolidations synchronized across a number of economies shrink any improvements in the current accounts because everyone’s current account cannot rise at the same time. What matters is how much consolidation an economy undertakes relative to other economies” ¿Pueden ser los esfuerzo fiscales una inutil “rat-race” http://en.wikipedia.org/wiki/Rat_race?