Discussion of

"Fiscal and Monetary Regimes: A Strategic Approach"

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Monetary and fiscal policy largesse: if spend you must, then do so "wisely"

- In the aftermath of the global financial crisis, *central banks* expanded their balance sheets to unprecedented levels and *governments* piled up public debt, so to prevent another Great Depression unfolding. It worked!
- Still, it is well understood (among economists) that sovereign defaults arise precisely as the burden of public debt becomes unsustainable.
- In particular when the spending gets tough, and despite major central banks' mostly undisputed operational independence, "arithmetic makes the strategies of the monetary and fiscal authorities interdependent" (Sargent, 1986).

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Wallace's "game of chicken" is alive and well, and grown to be quite strategic

- What do the authors' accomplish? They develop Wallace's well-known game of chicken, between a *central bank* (setting the price level) and a *government* (setting the real fiscal surplus) while facing incentives to default on debt obligations.
- Each authority incurs ("political") costs when straying away from its respective goal. Moreover, as in a true democracy, the cost of default affects equally all in society.
- The analysis sheds a bright light on the trillion dollar question: *which authority moves first and therefore imposes discipline on the other one?*
- My two cents under the lamppost: the fiscal authority ultimately controls the purse strings.

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Searching for insights and testable implications: a simple static game leads to a more dynamic one

- In a **static** game, the nature of the default costs is key for the interaction between authorities:
  - *fixed* costs imply a coordination motive
  - *convex* costs required for a "game of chicken"
- Such games without uncertainty predict unrealistically a high frequency of small defaults as a policy tool.
- Turning to a **dynamic** game, time inconsistency implies:
  - fiscal "irresponsibility" in rolling over public debt forces the central bank to inflate it away
  - monetary "responsibility" creating reserves to purchase public debt (QE) is inflationary
- In summary, a game where the fiscal authority moves first is the one that is least at odds with the facts.

The good, the bad, and the ugly

1. A good narrative: the authors' "strategic approach offers a narrative of the evolution of US public finances since 2008 as a situation in which the fiscal authority moves first, and forces ex-post excessive accommodation by the central bank, which should ultimately result in inflationary pressure."
2. Potentially unclear: "regarding balance-sheet expansion, the Fed holds both public and private assets, and the latter are absent from our theory..."
3. Pity not addressed yet: "capitalization of the central bank should be regulated by the mandate ex-ante rather than being mostly left to ex-post negotiations, as is by and large currently the case."

The beginning of the road

- In practice, the fiscal authority controls the purse strings.
- This paper, in sum, provides interesting theoretical insights and some testable implications.
- Micro-foundations warranted in future work.