

Discussion of
Tax Revolts and Sovereign Defaults
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The want operator

- Understand joint behavior of
 - ... Social unrest, demonstrations (tax revolts)
 - ... Government debt
 - ... Sovereign spreads
- Application to Argentina 2015 – 2019
 - ... Macri government's **gradual** approach to deficits
 - ... Early **default** by successor Fernández government
 - ... Positive correlation between spreads and political risk

Model predictions

- Left-wing governments default more often
- Right-wing governments issue more debt

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How it works

How it works: political economy

Agents

- Two households, L and R
- R is more **productive** and has a lower **disutility** of work
- Two political parties, Left and Right
- Utilitarian objective, same discount rate but different **weights**

Choices

- Party in power chooses default and labor taxes $\tau(y) = y - \tau_0 y^{1-\tau_1}$
 - L wants more progressive \implies L has lower debt tolerance [labor supply]
- Households choose the probability of reelection $\pi^{ij}(\mathcal{R}^i)$
 - Revolting reduces effective aggregate productivity α
 - R more exposed, esp. in repayment \implies R revolt less often than L in repayment

How it works: classical sovereign default

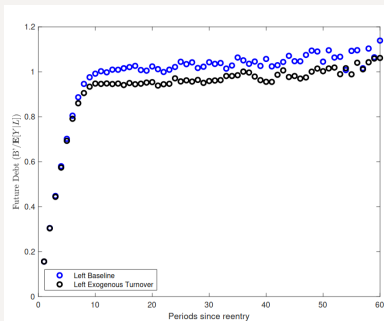
Debt choice

- With one party, to get spreads as in the data:
- Impatience \implies frontload consumption \implies debt stays near the default threshold

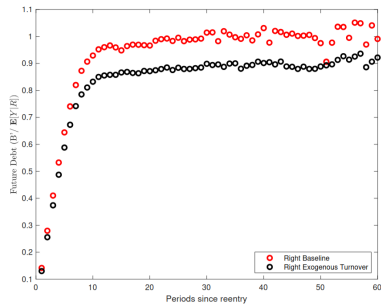
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(a) Debt under a Left wing party.



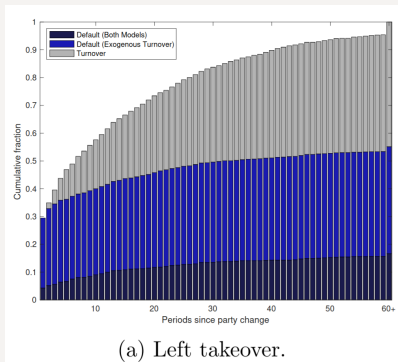
(b) Debt under a Right wing party.

R's normal debt level is within L's default region \implies political defaults

Comments

Revolts as endogenous default costs

- Revolting relatively cheaper in default $\implies \mathcal{R}$ more frequent in default
... makes default more costly relative to a model without revolts



- Revolts have two distinct costs: lower α and higher π^{ij}
- Suggestion: show defaults that would occur if \mathcal{R} did not affect turnover
... fix state-contingent revolt probability but remove the effect on α or π

Starving the Beast or Macri's Gradualism

Two theories

R finances tax cuts with debt to force *L* to reduce spending

R would like to enact regressive policies, uses debt instead to avoid revolts

- Instead of changing $\mathbb{P}(\mathcal{R})$ outside the model, understand how it moves within it
- Suggestion: measure how *R*'s choice of taxes and $\mathbb{P}(\mathcal{R})$ change with initial debt
 - ... Fix B at the average level of a $L - R$ transition, find $x^* = B'/B$ and (τ_0, τ_1)
 - ... As function of B : fix $B' = x^*B$ and τ_1 , adjust τ_0 : How does $\mathbb{P}(\mathcal{R})$ change?
 - ... Compare with case when τ_1 reacts optimally
 - ... Compare with case when (τ_1, B') react optimally

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Quibbles

- Why do households revolt?
 - In model revolts are purposeful: affect π^{ij} with productivity cost
 - ... is this a consensus view in political science?
 - ... perhaps: revolts increase the probability of maintaining status quo? [keeping τ_1]
- Why productivity and labor disutility?
 - Would this work if heterogeneity was capitalists/savers vs workers/HtM?
- Moments on different policies by L and R ? Perhaps untargeted?
 - Could bring in data on:
 - ... differences in progressivity
 - ... differences in income Gini pre and post tax
 - ... differences in output, spreads, debt levels, hours, even investment
- Two free parameters to avoid debt surges?
 - What about a cap on the one-period default probability?
 - ... low issuance costs in equilibrium \neq small distortion to decisions
 - ... debt surges are a convergence problem not an equilibrium problem anyway

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