Discussion of “International Reserves and Central Bank Independence” by Agustin Samano

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Summary

- **The question:** Why not use assets (reserves) to pay debt (and thus lower default risk)?
- **Agustin's theory:** The **patient central bank** accumulates reserves to mitigate overborrowing by the **impatient government.**
- Both reserves and debt increase in **good times.**
- Both reserves and central bank independence increased **over time.**
- **Very nice contribution to the literature**

Mechanism

- **Additional unit of reserves:**
  - lowers **equilibrium consumption** (mitigates overconsumption)
  - increases **debt** less than one unit (mitigates net overborrowing)
  - because it makes **the bond price more responsive to the debt level** (at the debt level that would undo the effect of the extra reserves unit on consumption)?
- is this a **plausible** mechanism?
  - **Empirical** investigation **beyond the scope of the paper**
  - Did **debt** increase less than reserves **over time?** (Yes? But it did not increase? Mexico?)
  - What does the model predict about the **response of spreads** to debt/shocks? Does this seem consistent with the data?

One-period debt

- Difficult to **interpret quantitative results**
  - **reserves to debt service ratio** much lower than in the data (maybe we shouldn't worry too much about that)
- **long-term debt** $\rightarrow$ **time inconsistency** in the accumulation of reserves:
  - more reserves in the future $\rightarrow$ higher future default probability $\rightarrow$ lower current bond prices
  - the central bank would want to **commit to lower future reserve levels**
  - independence does not imply commitment but this may be worth exploring (beyond the scope of the paper)

Computation

- Solving for the limit of the finite-horizon economy is faster (Hatchondo et al., RED 2010)
- Do you need to assume the government and the central bank move simultaneously?

Calibration

- The choice of making the **central bank and consumers impatient** (compared with the international cost of borrowing) is not obvious to me. What accounts for the difference between the domestic and the international interest rates? Are Mexicans more impatient? Expected depreciations? Risk?
- Why target the **correlation between total public debt and GDP?** (eliminate one target and use "standard discount factor"; target consumption or spread volatility) What is the stylized fact? Why does it matter?
- Why target the **debt stock** instead of the debt service?

Final comments

- The link between the **deterministic model and Alfaro and Kanczuk (2009)** is not obvious (in their model, the government may accumulate reserves to transfer resources to default states).
- Providing an **"implementable rule for reserves accumulation"** does not sound like a great idea (too much to ask from the model; may be misinterpreted; commitment)
- It would be nice to see a fuller set of moments for the simulations with the **consolidated government** (including average spread)
- It would be nice to see **welfare gains** from central bank independence across the state space

Conclusion

- Very nice paper
- Clear contribution to the literature
- Interesting questions for future research