

Comments on

Basu, Boz, Gopinath, Roch, and Unsal

**Integrated Monetary and Financial Policies
for Small Open Economies**

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This paper is part of the IMF's 'Integrated Policy Framework' (IPF) initiative.

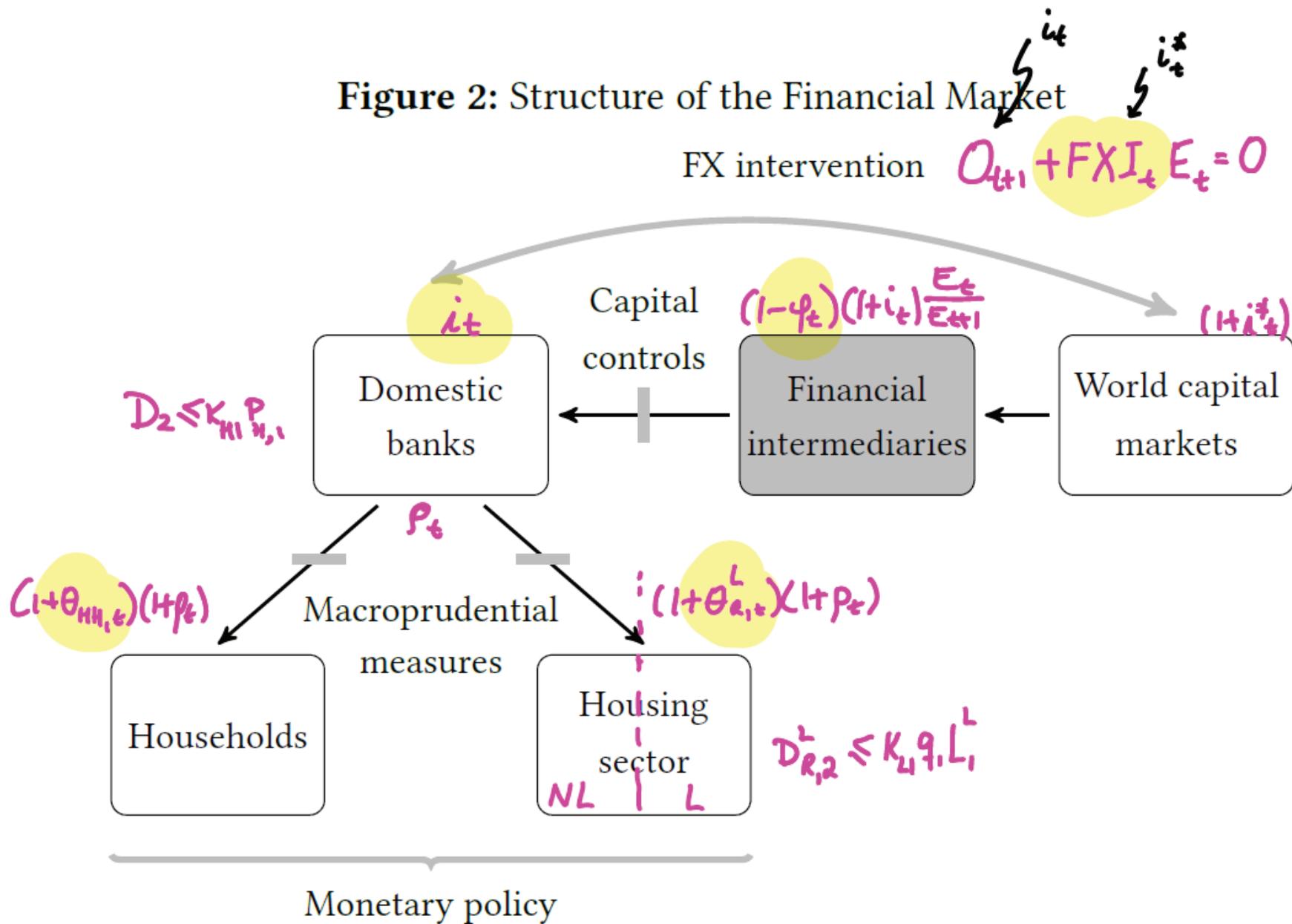
Framework

- 3-period, nonlinear, small open economy model
- 3 sectors: T (sticky price), NT (flex price), and commodities (flex price)
- frictions: nominal rigidities, collateral constraints, market segmentation
- 2 bonds, domestic currency and foreign (dollar) currency
- 5 policy instruments: capital controls (φ_t), nominal interest rate (i_t), 2 loan taxes ($\theta_{HH,t}, \theta_{R,t}^L$), FX intervention (FXI_t)
- Exogenous shocks: foreign appetite for domestic currency debt, or UIP, shock (S_t); debt limit shocks (either κ_{H1} or κ_{L1})

What the paper does:

- characterize optimal policy under commitment; some analytical results (5 Propositions) and some numerical illustrations.

Figure 2: Structure of the Financial Market



The need for an integrated policy framework: An example from the literature

policy instrument: capital control tax;

exogenous shocks: T-endowment and country interest rate.

Q: Is the optimal capital control policy procyclical (ie higher tax during boom and lower tax during bust)

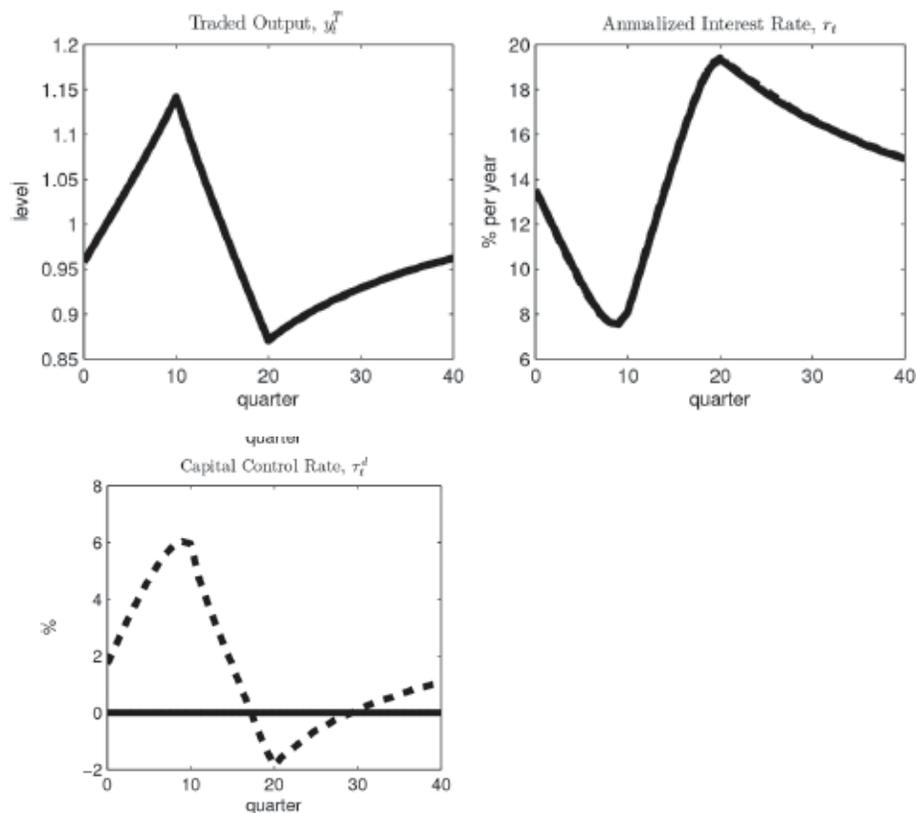
A: It depends on the friction.

model 1: friction is combination of downward nominal wage rigidity + peg → the optimal capital control tax is procyclical

model 2: friction is a flow collateral constraint → the optimal capital control tax is countercyclical

see the next slide

DNWR + Peg Friction

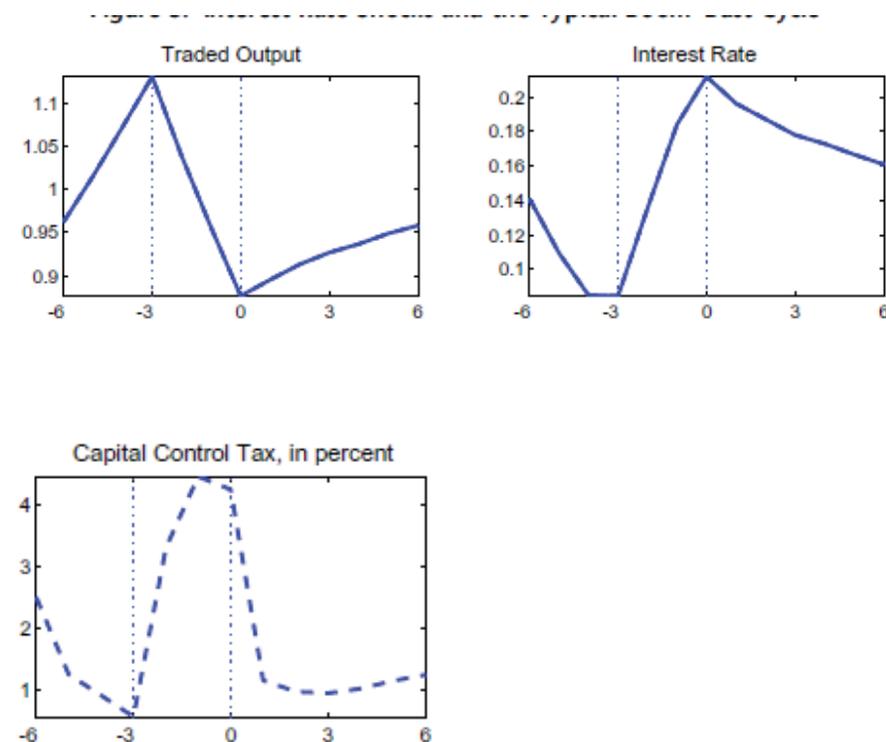


Source: Schmitt-Grohé and Uribe (2016), Fig 7

Friction: $W_t \geq W_{t-1}$ and $E_t = E_{t-1}$

- procyclical capital controls

Collateral Constraint Friction



Source: Schmitt-Grohé and Uribe (2017), Fig 3

Friction: $D_{t+1} \leq \kappa(y_t^T + p_t^n y_t^N)$

- countercyclical capital controls