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Comment

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In a commonly mentioned incident (although, as it turns out, an apocryphal one), F. Scott Fitzgerald opined, “The rich are different from you and me,” to which Ernest Hemingway replied “Yes, they have more money.”

“External Performance in Low-Income Countries,” by Lone Christiansen, Alessandro Prati, Luca Antonio Ricci, and Thierry Tresselt, revisits the Fitzgerald-Hemingway controversy. Do the rich (countries) differ from others, at least in terms of the determinants of the current account, the real exchange rate, and net foreign asset holdings? This is an interesting issue since it gets at the question of whether “development macroeconomics” is a distinct branch of macroeconomics. It is also an important issue because of its relevance for policy prescriptions: can policy for low-income countries be based on analysis drawn from empirical results for high-income countries?

One can think of two empirically relevant sets of differences in the determination of macroeconomic variables such as the current account, the real exchange rate, and net foreign asset holdings between rich and poor countries. First, there may be variables that are important in poor countries but either are not present or are of very minor importance in rich countries. For example, concessional loans may be an important source of (or response to) fluctuations in macroeconomic variables in poor countries, but not in rich countries. Second, differences in structure between low-income and high-income countries may lead to different relationships between variables that are relevant for both sets of countries. Here, one can imagine that the response of the current account to a change in the fiscal stance is fundamentally different in low-income countries than in high-income countries for a variety of reasons, including the more pervasive role of government in the former than in the latter.

In this paper, the results on the determination of the current account show that both of these sets of differences are possibly important. For

example, the estimates suggest that variables particular to low-income countries do, in fact, matter; concessional loans are significantly correlated with current account deteriorations. Also, the estimates presented here offer a statistically distinct difference between the current account response to variables common to both sets of countries; the estimated effect of the fiscal balance on the current account in low-income countries is positive, significant, and significantly different from the estimated effect in emerging-market and high-income countries, in which case the estimated effect is negative and insignificant.

In each of these cases, however, there is the possibility of endogeneity. For example, concessional loans are not made at random times, but typically represent responses to dire economic circumstances associated with current account deterioration. This is a reasonable interpretation of the negative coefficient on this variable. It is also possible that fiscal policy in low-income countries systematically responds to economic changes that are associated with swings in the current account, with fiscal consolidation in good times when the current account is in surplus and fiscal stimulus at moments when the current account is in deficit. The possibility of endogeneity makes it difficult to interpret the source of differences between low-income countries and the other countries used in the estimation. Even violent political transitions can be temporally correlated with current account deteriorations if a coup is more likely in the face of economic hardship. Thus, in this case too, it may be difficult to disentangle cause and effect.

Another challenge in interpreting these results is that theory distinguishes between events or policies that are temporary from those that are permanent, as well as from policies that are anticipated from those that were not expected to occur. For example, the immediate response of the current account to an unanticipated terms of trade shock depends on whether it is perceived as temporary or permanent.

One variable used in the analysis that satisfies the requirements of being exogenous, unanticipated, and perceived as temporary is the natural disaster dummy variable. Theoretical predictions for the impact of this variable on the current account are also straightforward, unlike many of the other variables in the estimation; a natural disaster, which represents an unforeseen, temporary, adverse shock to income, should lead to a current account deficit as a country attempts to smooth consumption and rebuild infrastructure. And indeed, the sign of the estimated effect for low-income countries is what we expect, but, interestingly, only for low-income countries with an open capital account. This is distinct from what is estimated for emerging-market and high-income countries. This

effect is not found for emerging-market and high-income countries. So the poor are different from the rich, but the poor are also divided into distinct groups, in this case depending on their own policy choices.

These results point to a broader question: Are there other significant differences among the low-income countries due to policy choices, endowments, institutions, or other factors? Of course, there needs to be a balance between searching for more finely grained distinctions and having sufficient observations, as well as something useful to say about systematic responses. The role of capital account openness in the response of low-income countries to natural disasters, however, suggests that it might be important to distinguish among groups of low-income countries.

The results in this paper also indicate that poor countries differ from the rich with respect to the determination of the real exchange rate. This is not true for all variables: higher government consumption is associated with an appreciation of the real exchange rate in both low-income and higher-income countries, and the estimated effects are not statistically distinct. But in other cases, there is a statistically significant difference. The coefficients on agricultural price controls are statistically distinct between the two groups in some cases, but the coefficients for the low-income countries are not themselves statistically significant. In the case of aid, however, both low-income and higher-income countries have estimated effects that are significant but of different signs. Higher aid to low-income countries is estimated as causing a real exchange rate depreciation, whereas the estimate for higher-income countries is that aid leads to an appreciation. The result for low-income countries is at odds with other research that shows a Dutch disease effect of aid to low-income countries (Rajan and Subramanian 2008). Perhaps this is another example of endogeneity, with aid flows rising in the face of economic difficulties that are associated with a weakening of the real exchange rate.

Christiansen et al. have constructed an impressive data set that includes data on both low-income and economically advanced countries. They are just beginning to reap the rewards of this work. Those interested in the macroeconomics of developing nations will look forward to more research that draws on these data.

Reference

- Rajan, Raguharam, and Arvind Subramanian. 2008. "Aid and Growth: What Does the Cross-Country Evidence Really Show?" *Review of Economics and Statistics* 90 (November): 643–65.