

A Model of Balance-of-Payments Crises due to External Shocks: Monetary vs. Fiscal Approaches

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Abstract

This paper develops a model for balance-of-payments (BOP) crises triggered by an external shock. Whether an external shock induces a BOP crisis depends crucially on the sequence of policy actions taken by the government's monetary and fiscal authorities. If the fiscal authority moves first and imposes an exogenous constraint on the monetary authority, an external shock can lead to a BOP crisis. However, if the monetary authority moves first and imposes an exogenous constraint on the fiscal authority, the same shock does not cause a BOP crisis.

Keywords: Balance-of-payments crises, External shocks, Sequence of policy actions

JEL Classification: F3

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