Discussion of:

International Credit Flows, Pecuniary Externalities, and Capital Controls

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Is capital mobility good under frictions?

- Large literature on inefficiencies from pecuniary externalities.
- Develop a general equilibrium model with endogenous output and portfolio choice.
  - Contrast: first best, bond-only financial integration, financial autarky.
- Findings:
  - Specialization when wealth is evenly distributed.
  - Partial specialization under wealth polarization, loss of terms-of-trade hedge, possibility of sunspots.
  - Financial autarky leads to higher welfare.

Comment 1: wealth polarization

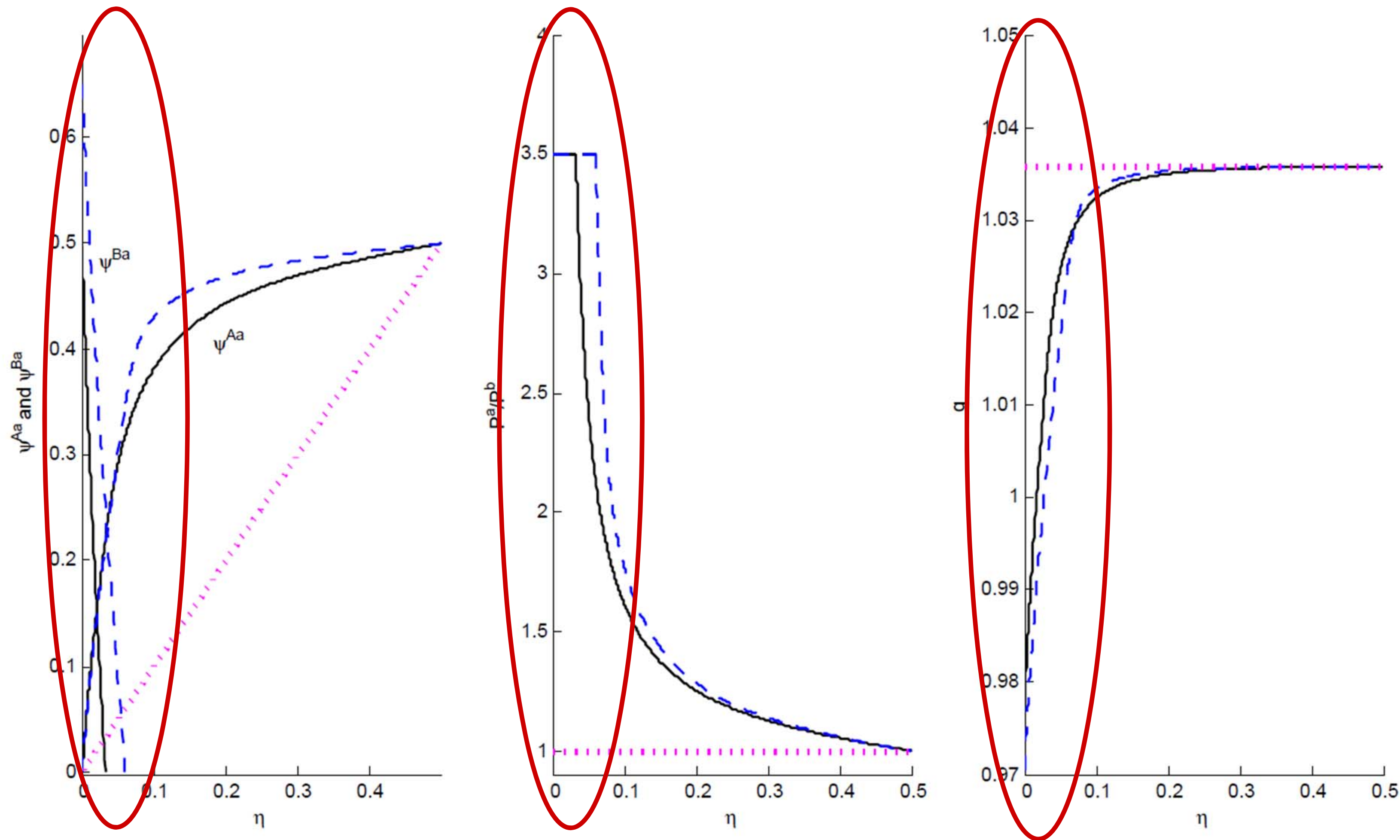


Figure 1: Panel A plots the **capital shares** ψ^{Aa} and ψ^{Ba}, Panel B plots the **terms of trade** P^a/P^b and Panel C plots the **price of physical capital** q, as functions of the **wealth share** η, for three different levels of elasticity of substitution: $s = 0.5$ in dashed blue, $s = 1.01$ (Cobb-Douglas) in solid black, and $s = \infty$ in dotted magenta.

Comment 1: wealth polarization

- The effects stressed by the paper occur only when η is very low (or large).
  - Is this empirically realistic?
  - Provide some motivating data.
- Key role (apparently) of the upper bound for the terms-of-trade (a upper / a lower).
  - What happens in the absence of such a bound?
  - Example: differentiation across brands (some produced in A others in B) in sectors “a” and “b”. Both sectors are always produced in both countries, but in different quantities.

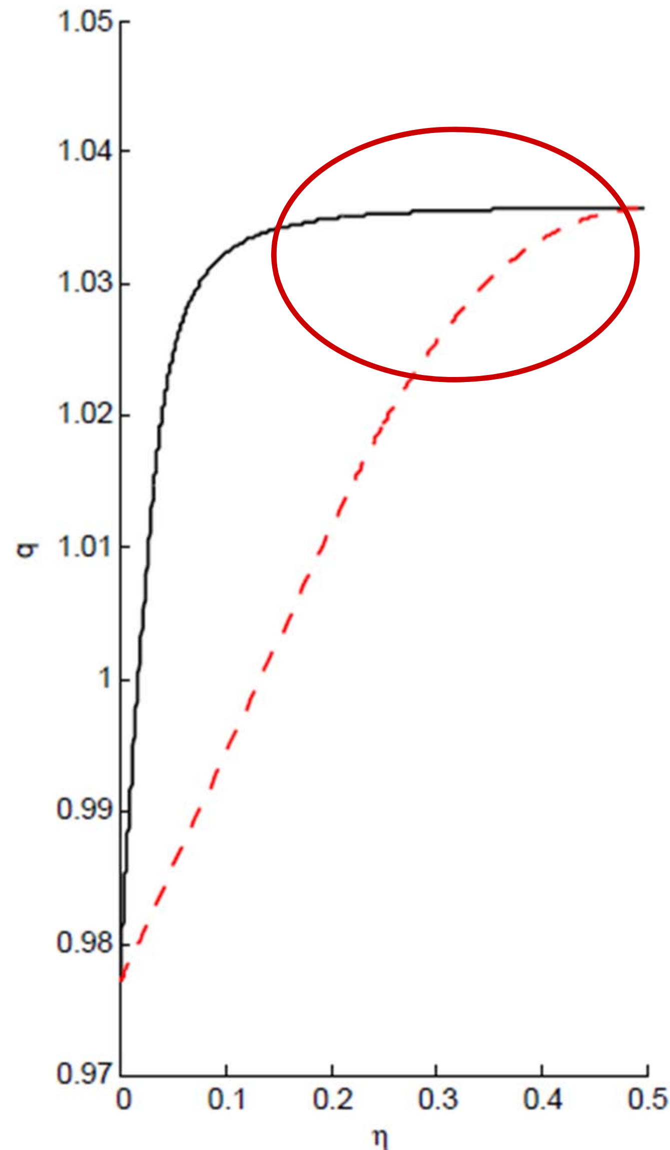
Comment 2: planner vs. decentralized

- The paper contrasts capital (bonds) mobility and autarky.
- What is the constrained planner allocation when only bonds can be traded (better benchmark than first best)?
  - Would a scheme of (possibly time varying) debt tax / subsidy lead to a better allocation (Mendoza)?
- The welfare gains under the constrained planner allocation could be larger than under the sharper financial autarky assumption.
- Would policy cooperation help, possibly through a multilateral institution?
  - Swap lines to handle sunspots, redistribution when wealth gets polarized.

Comment 3: equity

- Only bond trading under incomplete markets (but partial equity could be considered).
- Present the model with equity, under domestic portfolio bias (iceberg cost on foreign holdings).
  - Can some presence of contingent assets dampen the inefficiencies stemming for excessive debt?
  - Possibility of taxing debt and subsidizing equity.
  - Link to macroprudential measures in the debtor country (e.g. reserve requirements for banks).

Comment 4: prudential indicators



- Under financial autarky changes in wealth distribution quickly impact asset prices.
- Not the case under financial integration.
  - Can lead to complacency as financial markets remain stable.
- Impact on asset price is instead large and sudden.
- Harder to gauge risks to financial stability under integration.

Comment 5: some modeling points

- Inclusion of other shocks (such as discount factor shocks, to proxy for savings «gluts»).
- Decreasing returns to scale technology to avoid some knife-edge problems (such as extreme wealth polarization under full substitutability).
- Welfare analysis in terms of consumption equivalent units.