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Comment Youngsun Koh

This paper discusses a framework for optimal balance sheet management from the tax-smoothing perspective and concludes that the Future Fund

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of the Australian government should be invested in a broad range of financial assets that includes nominal domestic debts and foreign equities. The optimal portfolios derived through numerical exercises are not sufficiently credible in quantitative terms, but they give strong qualitative implications that are based on a sound economic reasoning and match our intuitions.

Korea is another country that is accumulating a large amount of government assets. The National Pension Scheme (NPS) that was introduced in 1988 requires a minimum 10 years of contribution for full old-age pension benefits. For now, there exists a far larger number of contributors than beneficiaries, and the annual surplus amounts to 3 to 4 percent of GDP. At its peak, the stock of assets is expected to exceed 100 percent of GDP, and then fall as benefit payments increase rapidly.

The NPS fund is invested mostly in domestic fixed-income assets, and none in foreign assets. There are talks of increasing the share of equities, and also of investing in foreign assets. Without such diversification, NPS is likely to have distortionary effects on domestic financial markets. The framework suggested in the paper provides a good starting point for the diversification of NPS assets. It would be interesting to check whether a similar numerical exercise leads to a similar optimal portfolio including nominal domestic debts and foreign equities.

Still, this approach will entail several problems when applied to the Korean NPS. Most serious is the rapidly changing economic environment in Korea. The annual growth rate, recorded at over 8 percent in past decades, declined to around 5 percent after the recent economic crisis, and further deceleration is expected in the future with the rapid population aging and the technological catch-up with advanced countries. It would be very naïve to believe that the variance-covariance matrix remains unchanged in this changing environment.

An equally important question concerns the parameter endogeneity (not policy endogeneity as discussed in the paper). Due to its very large volume, the portfolio selection of NPS can affect the market returns and the variance-covariance matrix; NPS may not be a price-taker but a price-setter. Similarly, its foreign investment can affect the exchange rate and the rate of return in terms of domestic currencies.

Despite these limitations, however, the framework suggested in the paper provides a very useful benchmark on which modifications can be made to reflect the realities more closely. Future works in this direction are called for.