

Discussion of: Globalization and Risk Sharing

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The Question

- How does globalization - an increase in international trading opportunities - affect risk sharing?

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- Empirical relevance

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- Empirical relevance
- Theoretical issues

Empirical Relevance, I

- Bai and Zhang, 2005:

$$\Delta c_{it} = \alpha \Delta C_t + \beta \Delta y_{it} + \epsilon_{it}$$

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| Industrial | 0.56 (0.04) | 0.67 (0.03) |
| Developing | 0.77 (0.06) | 0.90 (0.03) |
| All | 0.72 (0.04) | 0.84 (0.02) |

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- Related finding in Prasad, Rogoff, Wei and Kose (2002)
- Globalization coincides with lower inter-national risk sharing! (caveat)

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- Latin America during financial crises large increases in inequality/poverty (Nora Lustig 02)
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- The theoretical link between globalization and risk sharing seems worth thinking of (not much besides McLaren and Newman, 2002)

An ultra-simplified BV model

- 1 period
- Two countries, 2 domestic cons., 2 foreign, 2 states
- At the beginning of t consumers trade complete set of AS, to insure against
- Aggregate risk α , Idiosyncratic risk ι

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|----|---------------------------|---------------------------|---------------------------|---------------------------|
| | C1 | C2 | C1 | C2 |
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- Non discriminatory enforcement: default on all AS payments iff it increases welfare of each consumer

Results

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- Key tradeoff is between idiosyncratic risk (high in default) and transfers from abroad (also high in default)
- Model globalization as an increase in α
- Globalization leads from FB to autarky (in a sudden stoppish way)

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 - Pesification in Argentina 2002?

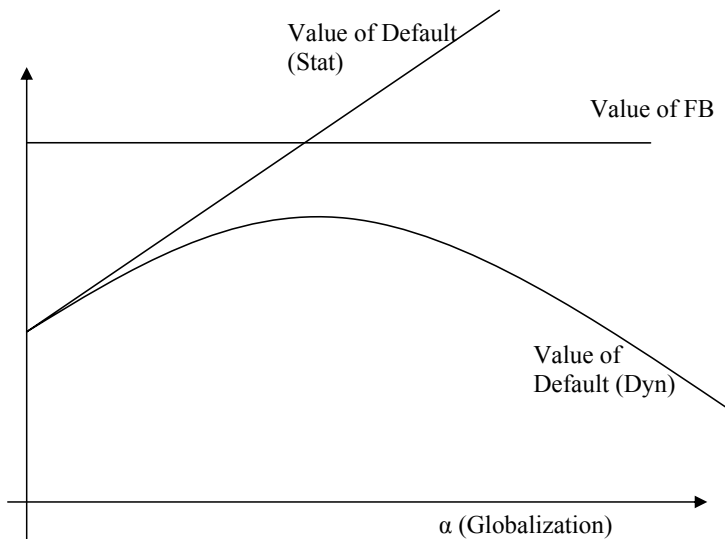
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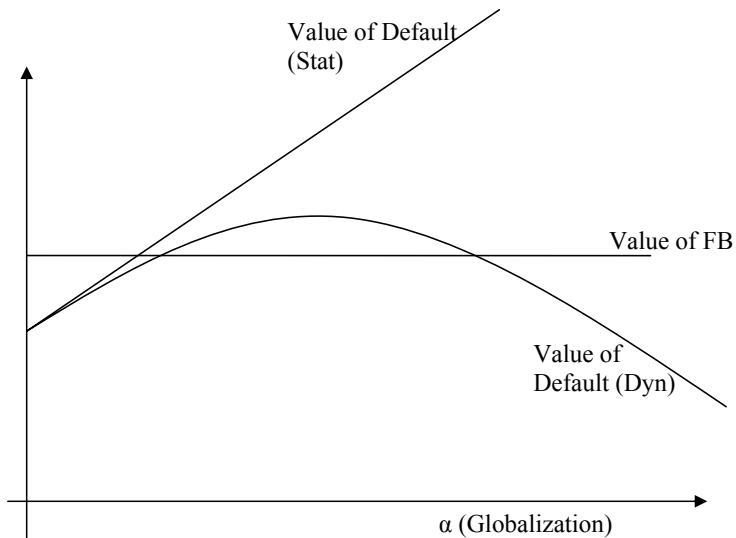
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 - Pesification in Argentina 2002?
- Static set-up
 - In a dynamic set-up in which punishment is exclusion, globalization increases current incentives to default but also future costs. Net effect is unclear

Globalization and the value of default, case I



Globalization and the value of default, case II



Conclusions

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- Relation between globalization and risk sharing needs to be explored
- This paper makes an important step in that direction!