Discussion of: Globalization and Risk Sharing
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- How does globalization - an increase in international trading opportunities - affect risk sharing?

The Question

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- Empirical relevance

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- Empirical relevance
- Theoretical issues

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- Bai and Zhang, 2005:

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	β	
	$1973 - 1985$	$1986 - 1998$
Industrial	0.56	0.67
	(0.04)	(0.03)
Developing	0.77	0.90
	(0.06)	(0.03)
All	0.72	0.84
	(0.04)	(0.02)

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

Empirical Relevance, II

- 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

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- 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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S1	$(1+\alpha)(1+\iota)$	$(1+\alpha)(1-\iota)$	$(1-\alpha)(1-\iota)$	$(1-\alpha)(1+\iota)$
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- Non discriminatory enforcement: default on all AS payments iff it increases welfare of each consumer

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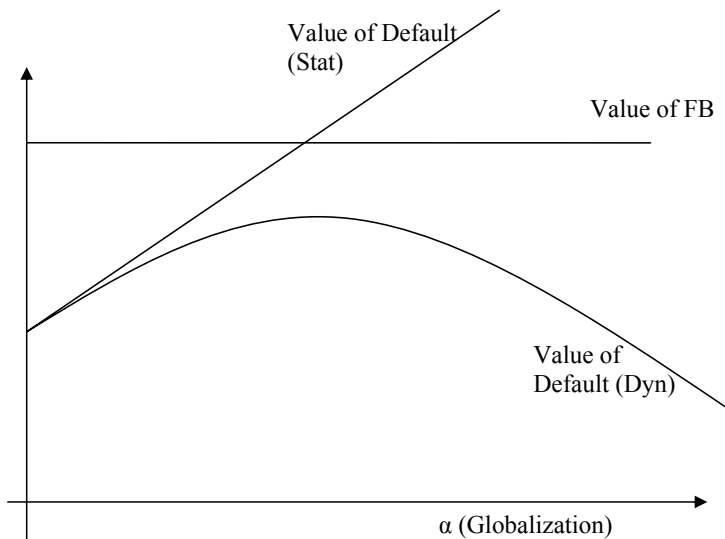
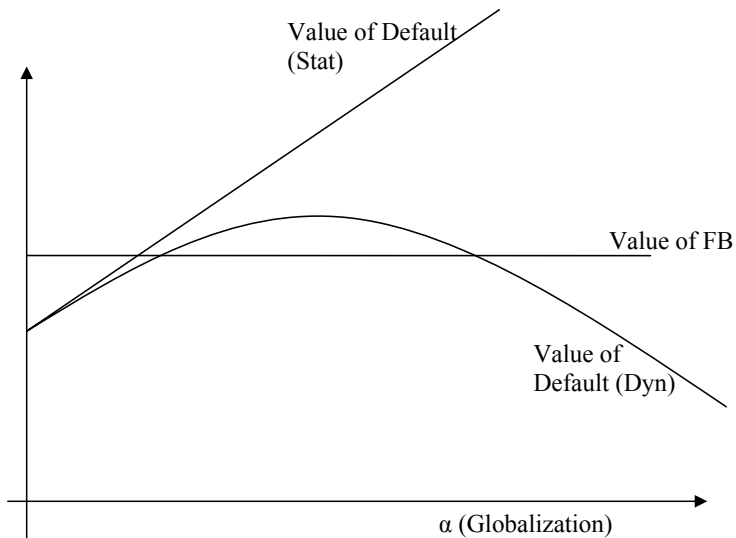- Non discriminatory enforcement
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- Static set-up
  - In a dynamic set-up in which punishment is exclusion, globalization increases current incentives to default but also future costs. Net effect is unclear

Globalization and the value of default, case I

Value of Default (Stat)

Value of FB

Value of Default (Dyn)

α (Globalization)

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- This paper makes an important step in that direction!