Comments on Anusha Chari et al. "Does Capital Scarcity Matter?"

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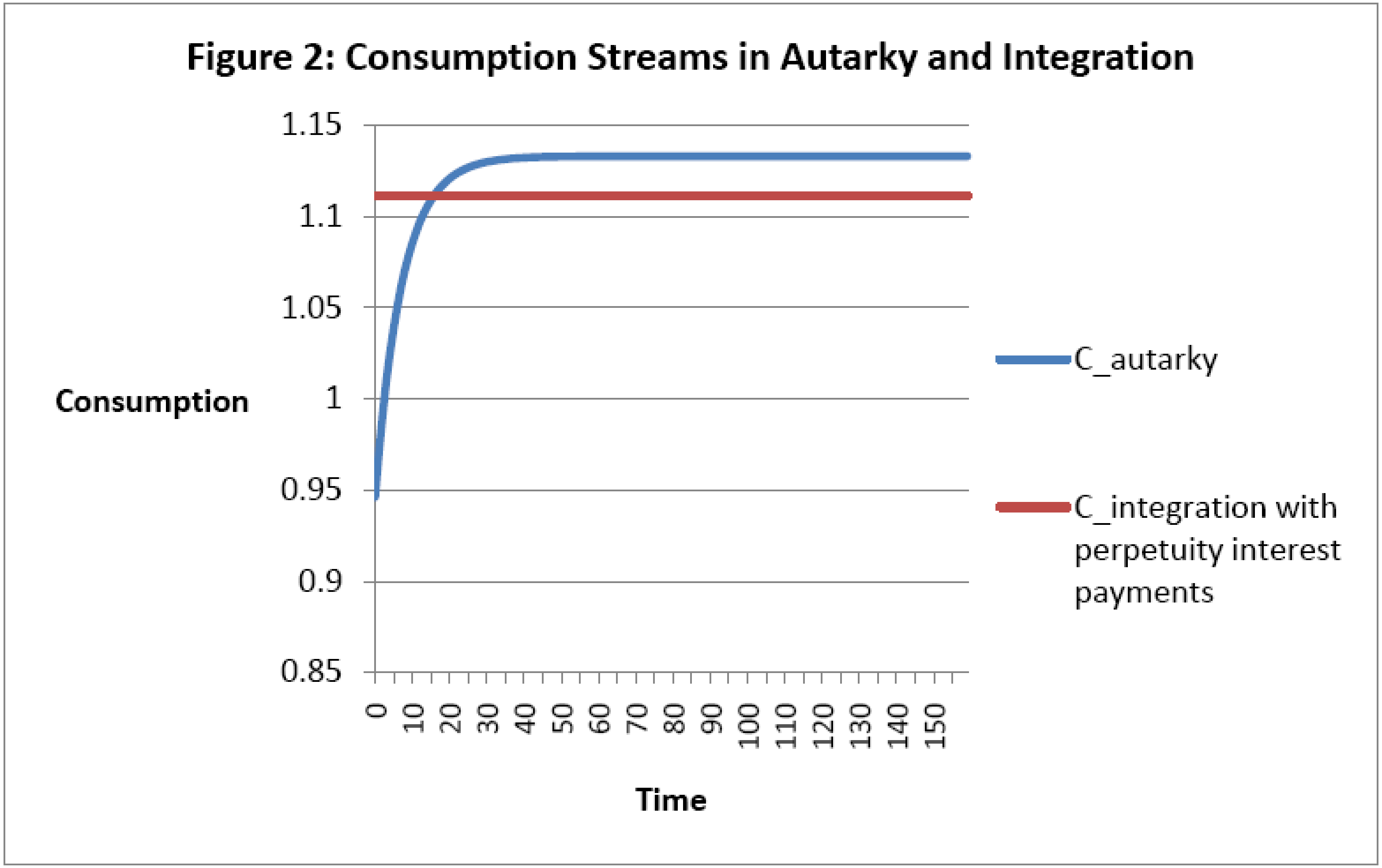
Theme

- Evaluate Gourinchas and Jeanne's (2006) low estimates associated with welfare gains of financial integration compared with autarky

Basic Gourinchas and Jeanne

- Neoclassical growth model
  - Infinite horizon
  - Representative agent
  - Exogenous productivity growth
  - All countries alike except they have different starting points of capital to effective labor (non-steady state)
  - Small country, so capital inflow is large enough to instantaneously raise integrated economy's capital stock to steady state level (same for every country)
  - No costs to installing capital quickly

Gourinchas and Jeanne



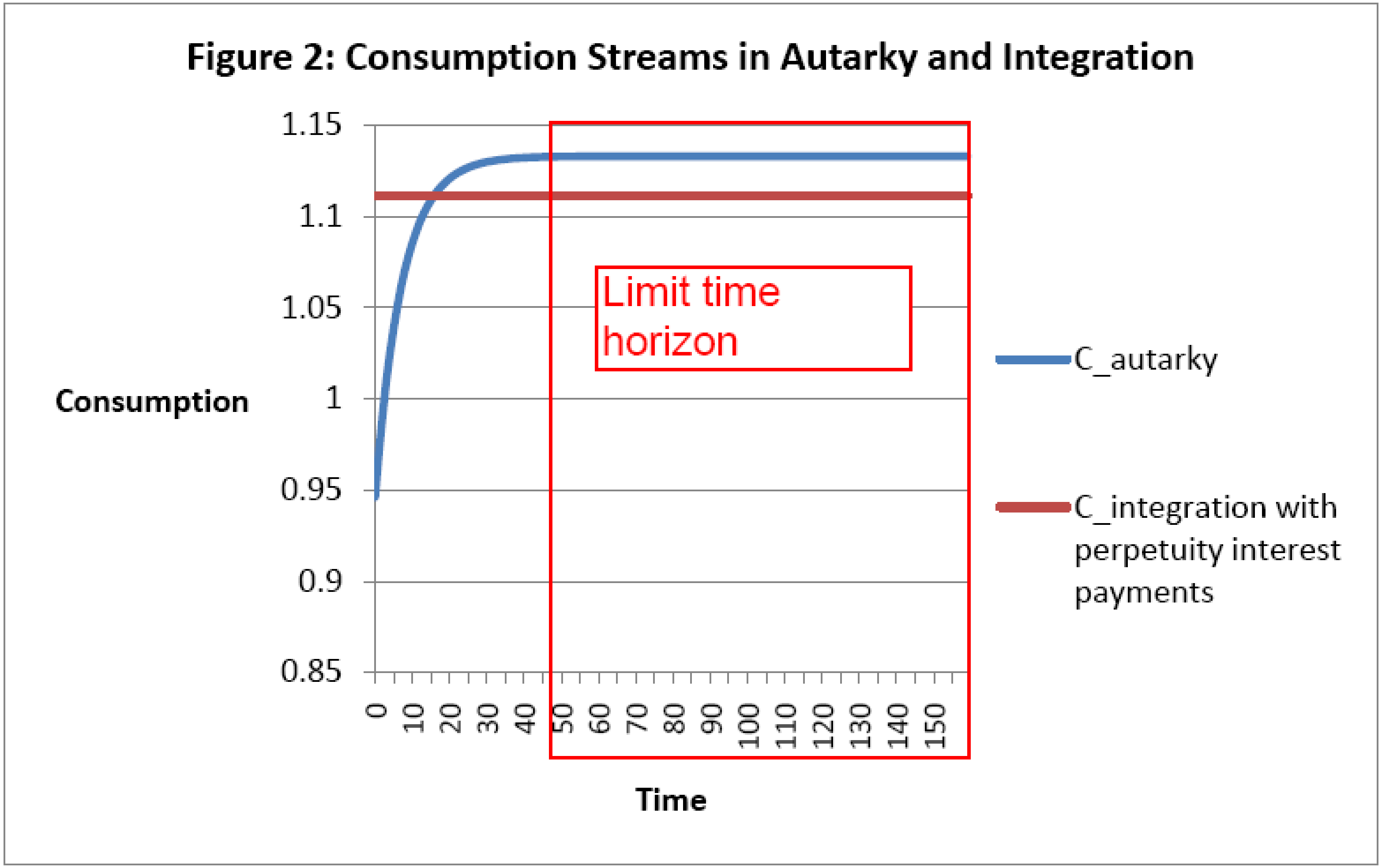
Find small gains in welfare for infinite horizon model: "world" starts at k/y=1.6 (pop weighted) and should increase to k*/y*=2.63. Gives welfare gain equivalent to 1.74% of annual consumption level.

Chari et al.

- Argue that infinite time horizon underestimates welfare gain
- Most gain is in early integration period

1. Decrease Time Horizon and get greater benefits to integration.

   Why? Never repay principal, just interest, so long run consumption in integration is lower



Chari et al.

- Show that gains for “average” set of countries hide especially large gains for especially low k/y countries (potentially large rise in k/y)
- Suggest that debt contracts matter: how the foreign debt is rapid
  - Implications of imposing transversality condition?
  - If pay as a simple loan, interest plus principle over fifty years
  - Find that these give larger welfare gains

Comments

- Shorter Horizons increase welfare effects
- Best benchmark is 50 year repayment since at that point steady consumption is same under autarky and integration…
  - Surprising…in a model with no uncertainty, all countries alike, isn't there a foreign debt "Modigliani–Miller theorem"?
- Careful calculation of alternative scenarios using real data on k/y from Penn tables…
- Show welfare gains are model dependent

More model dependence more gains to integration

- Productivity increases if integrated in the world…welfare gains of integration

- FDI suggests there is some attribute associated with foreign capital that adds not just capital but technology and processes to world frontier
  - Welfare gains to integration

- More efficient domestic financial system…competition, etc.

Model specific: overestimate gains?

- Capital stocks don’t jump discretely but there are costs to installing capital quickly…reduce welfare of integration

- Risk: foreign risk premium (beyond domestic premium– confiscation risk, exchange rate risk, political risk, etc.)…reduce welfare of integration

Why neoclassical model may not be best framework…

- Why not more international capital flows?
  Almost all domestic investment in EM financed via domestic saving

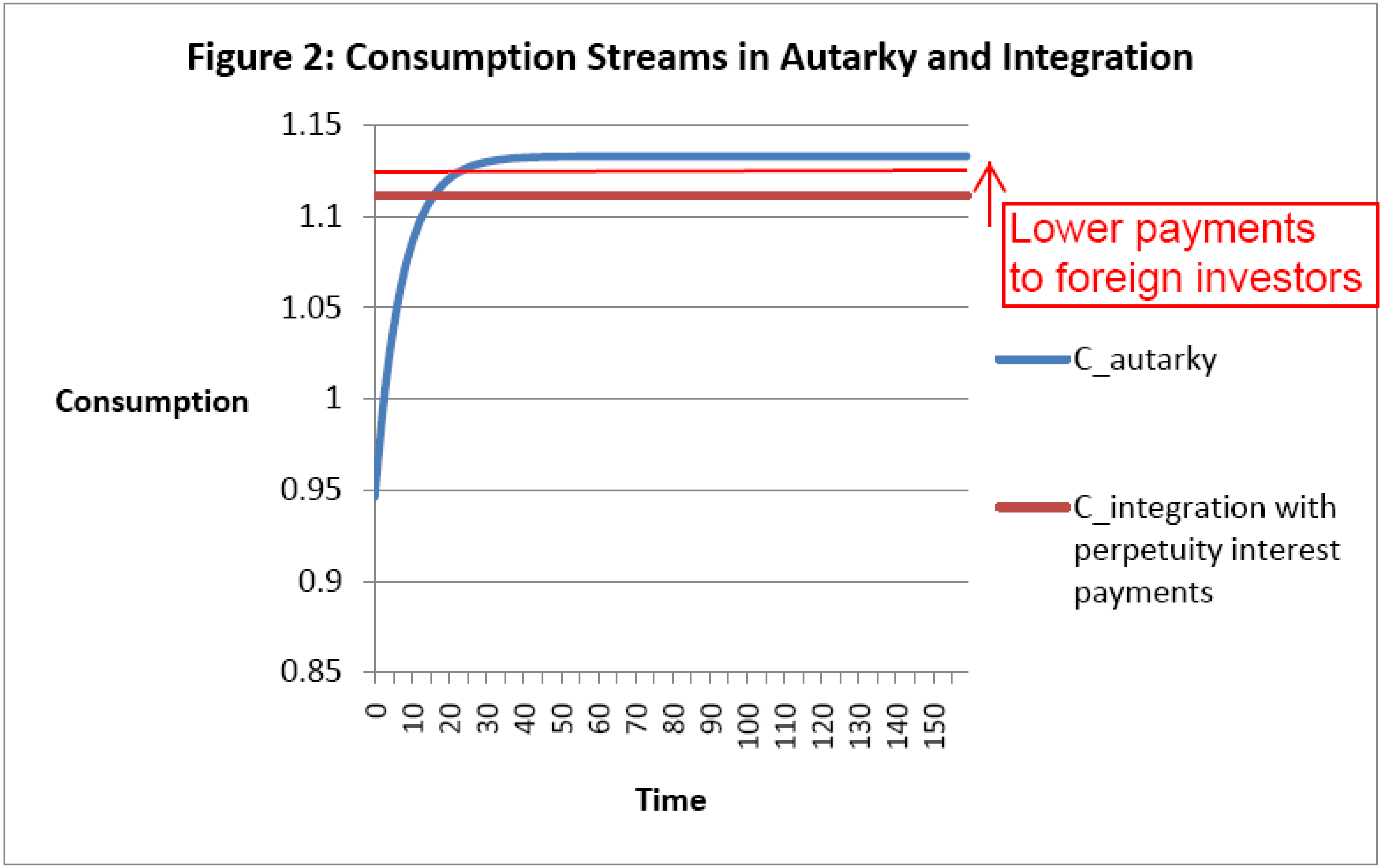
- Why North to South capital flows?

- Costs of foreign capital?
  - Volatility and sudden stops of “hot money”
  - Macro management
  - Corruption

Overall

- Interesting paper and thoughtful
    - Preliminary so lot's of room for extensive
- Work so far carefully carried out and useful critique of Grourinchas and Jeanne
- Financing issues not entirely clear
- Limitations of neoclassical framework for evaluating benefits from capital flows and financial integration still apparent

2. Lower payments to foreign investors



3. Increase discount rate