Manufacturing - Finance Comparative Advantage and Global Imbalances

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ABFER Inaugural Conference

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May 21, 2013

Comments: Model

- Do you think it is necessary to have a static model which predicts $CA = 0$ in a paper on global imbalances?
  - Merge the two models into a single one that has CA predictions

  I don't understand some aspects of the modeling setup

- You seem to have an externality in the model: households choose to give capital, but for 0 direct return
  - The return comes in the form of a higher wage next year
  - "wage return" $= 1 + r$ to facilitate the existence of two assets in a risk-free world
  - This is not a standard competitive equilibrium setup with price-takers
  - It seems you may be solving some kind of central planner's problem, which in your case doesn't equal the competitive allocation.
  - In a competitive allocation, households would choose $K = 0$

Comments: Model

- Is this a well-defined steady state?
  - The within-generation problem has consumption smoothing and growing $|CA|$
    - ★ Consumption is constant in each generation: $C = \frac{1}{1+\beta}\left(Y_1 + \frac{Y_2}{1+r}\right)$
  - But with a constant interest rate and no risk, your model seems to have a unit root in NFA ($NFA \to \pm\infty$), possibly as a fraction of ouput
- Schmitt-Grohe & Uribe 2003 JIE show that SOE models with incomplete asset markets exhibit dependance on initial conditions, and so are inconsistent with a steady state growth path
- Stability which prevents transient shocks from having permanent consequences needs to be induced by, e.g., debt-elastic interest rate, convex adjustment costs, etc.
- What are the stability properties of your model?

Comments: Model

- The point you are making with the model is very intuitive and simple
- In a two-country world with perfect specialization, one country will end up making manufacturing stuff, the other will produce financial services
- Do you really need a very complex model to say this and bring idea to the data?

Comments: Empirics

- Empirical exercise very similar to Chinn and Prasad (2003, JIE)
- One new variable: Relative labour productivity
- They cover 89 countries, you cover 24: probably can increase sample?
- Results are mostly consistent with Chinn and Prasad (2003)

Comments: Empirics

Why this country selection?

- Two-country model, but data only for small open economies.
  - The main feedback loop in your model – the dependance of interest rate on country characteristics (productivity) – need not be satisfied in the data.
- There are no CA-creditor countries in the sample except for Korea and Germany (Canada in a some years)
- Would be nice to see more Asian economies and the US, especially since the usual paradigm in explaining global CA imbalances is "East vs. West"

Comments: Empirics

Why this country selection?

- Another reason why it would be nice to see more Asian countries:
  - Singapore, Hong Kong: world financial centers
  - Also very important manufacturing centers
  - But my guess is that their comparative advantage is in finance, not manufacturing
  - Singapore and Hong Kong run large CA surpluses
  - May not support the theory

Comments: Empirics

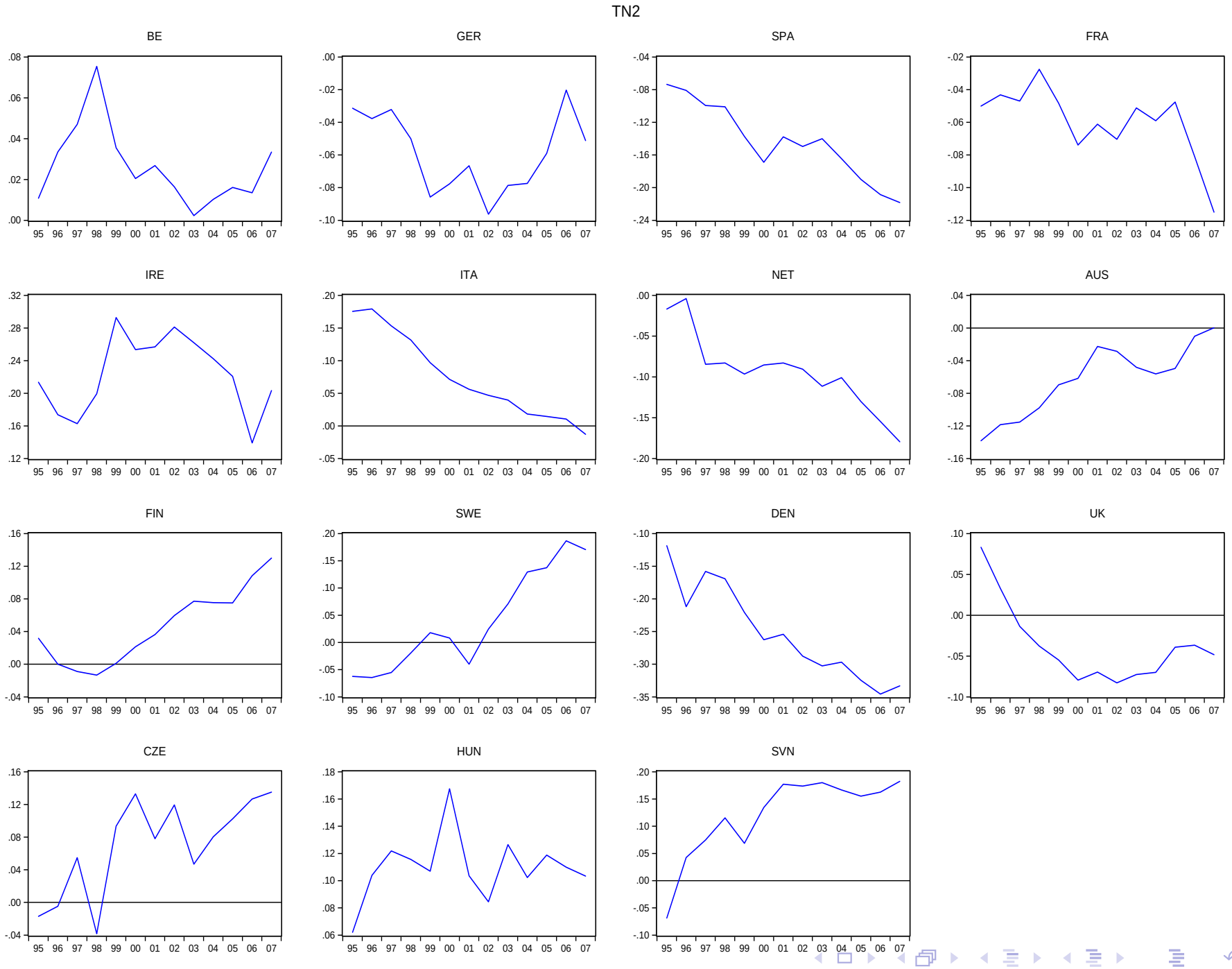
- Link between Fiscal and CA balances
  - "Twin deficit" literature concludes no long-term relationship (some decades $+$, some $-$)
  - This is because both CA and FB driven by shocks
  - Persistence and the degree of commonality across countries matter for results

Comments: Empirics

- Output per worker is an imprecise measure of what you mean by "productivity"
  - Imprecise measure of TFP: Both Y and L respond endogenously to TFP
  - On the flipside, Y/L can also move when TFP doesn't:
    - ★ non TFP induced changes in K
    - ★ policy changes
    - ★ tax change
  - These are particularly relevant issues when looking at long (growth) horizons

Comments: Empirics

- I use a panel of constructed sectoral TFP levels from another project
- TFP_{Man} / TFP_{Fin} levels do not suffer from the above issues
- Should give clearer evidence of link between *TFP* and *CA*
- No other variables, but that may work against me
- Smaller sample: only half of your countries, plus UK, Belgium and Slovenia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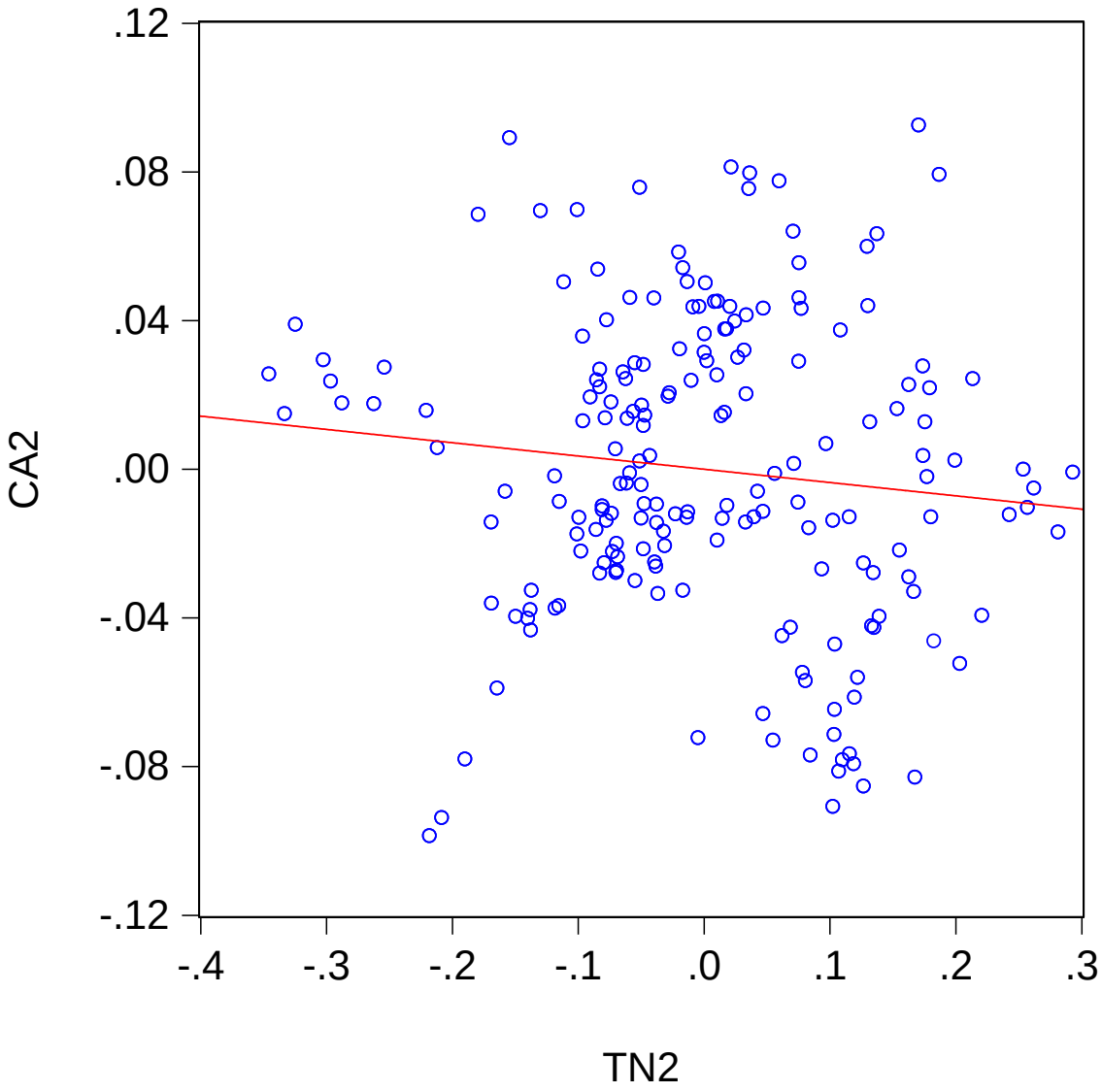
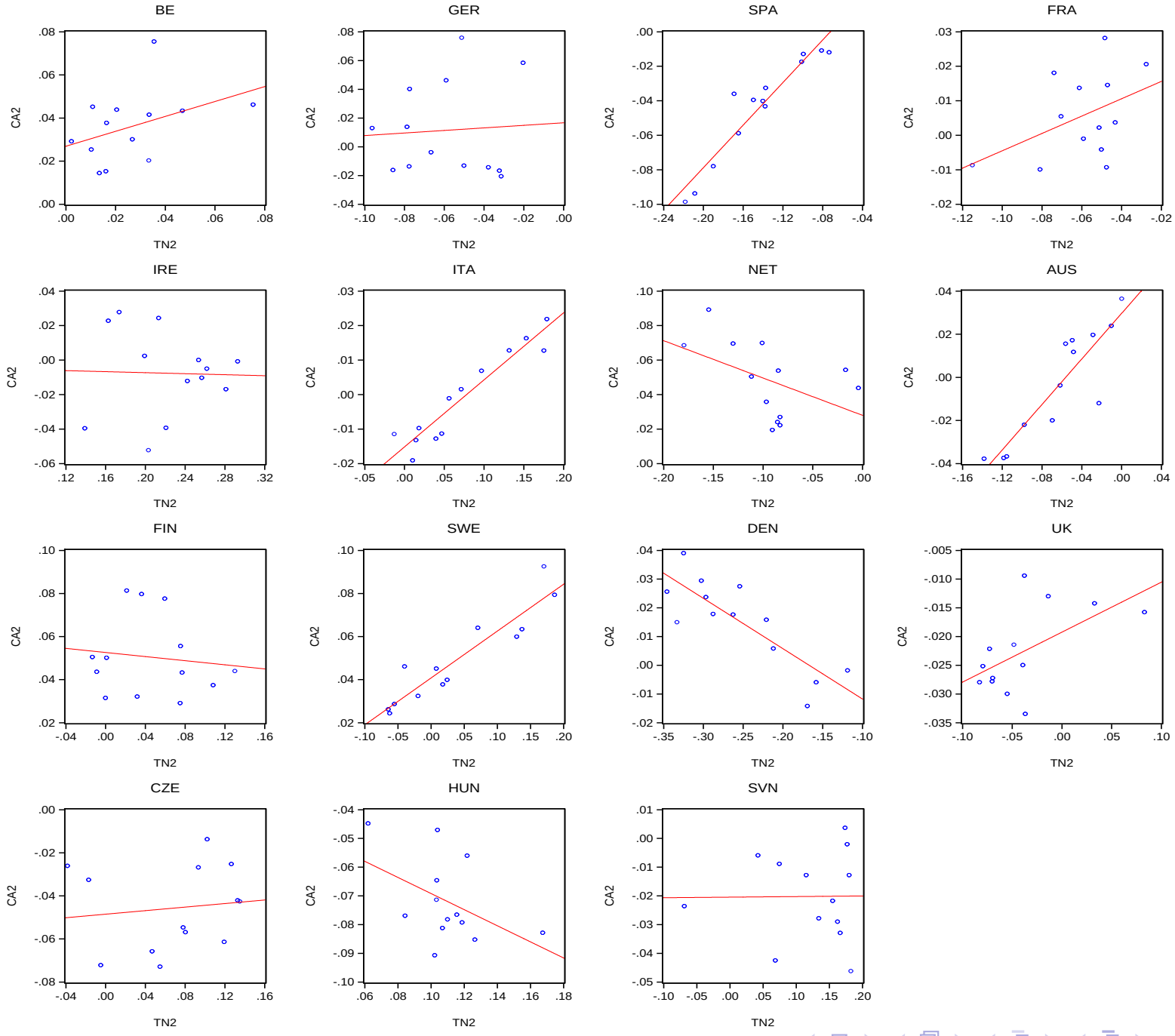
TFP_M / TFP_F vs CA: no clear link

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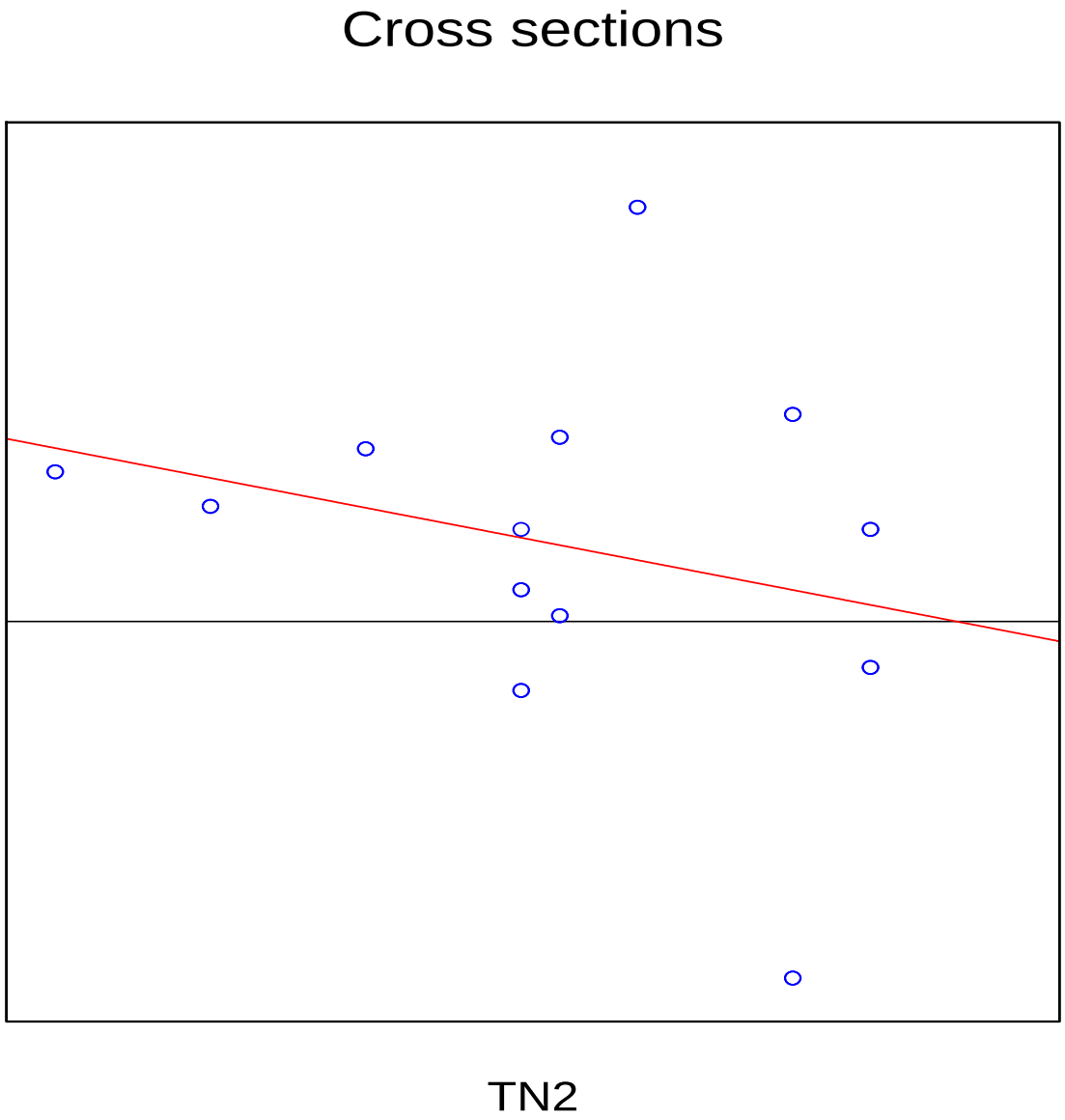
TFP_M / TFP_F vs CA in cross-section



Pool vs Fixed effects panel

Dependent Variable: CA (constant not reported)
Sample: 1995 2007
Total panel (balanced) observations: 195
Period weights (PCSE) standard errors & covariance (d.f. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TFP_M / TFP_F	-0.035	0.024	-1.459	0.146

R-squared	0.011923
Adjusted R-squared	0.006803
F-statistic	2.328872

Dependent Variable: CA (constant not reported)
Method: Panel EGLS (Cross-section random effects)
Total panel (balanced) observations: 195
Swamy and Arora estimator of component variances
Period weights (PCSE) standard errors & covariance (d.f. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
TFP_M / TFP_F	0.078	0.030	2.567	0.011

Weighted Statistics

R-squared	0.040284
Adjusted R-squared	0.035311

Unweighted Statistics

R-squared	-0.108925
Sum squared resid	0.363481

Comments: Empirics

- Results go in opposite direction from yours: pool insignificant, CFX significantly positive
- Time-series drive the results
- But with only 15 years of data, your growth story should really come through in cross sectional results
- This does happen when using Y/L but not when using TFP