Comments on Paper 5

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In this paper, Professor Chinn provides a great survey of vast literature on various international macroeconomic issues and also suggests a number of helpful insights contributing to current global macroeconomic policy debate.

The paper consists mainly of three parts. The first part of the paper focuses on the question how important the global imbalance is in explaining the current global crisis. To deal with the question, he first reviews critically a wide range of literature which provides a spectrum of explanations on the global imbalance. He covers the traditional saving-investment approach, intertemporal approach, mercantilist behavior, global saving glut, and distortions in financial markets as potential explanations for the imbalance and he summarizes contributions and limits of each explanation in turns. In the second part of the paper, he considers international trade linkage as a propagating mechanism of the global crisis and reviews various hypotheses on "the great trade collapse" such as the compositional effect of durable goods and trade credit. In doing so, he draws attentions on the role of Chinese stimulus package in preventing the drastic collapse of the world economy. Then, he concludes his paper with evaluation and discussion of current state of the world economy with regard to the global imbalance and policy responses needed to restore the global balance. Based on the evaluations and projections of current state of the global economy, he expects a two-speed global recovery in that the downside risk of deflation is apparent among core advanced economies including U.S. while overheating is more likely to happen among in developing countries. Also, he assesses that the rebalance process is not going to proceed apace at least with current policies.

Before making my comments on this paper, let me emphasize that I do not have any strong disagreements with Professor Chinn with regard to his analysis and conclusion. However, I hope to make two remarks for further discussions. The first one is related with cause of the global imbalance. Among the potential explanations on the global imbalance, he seems to particularly emphasize the role of financial market distortions both in developing countries and advanced economies in causing financial crises in core advanced economies. That is, financial

distortions such as insufficient financial intermediations in developing countries generated excessive savings in the region mainly through the channel of precautionary motivation and the excess savings flowed into core advanced countries, particularly the U.S. due to improper macroeconomic policies and financial distortions in the regions and played an important role in inducing financial crisis in the U.S.

However, in my opinion, financial distortions exist not only in individual country's domestic financial market but also in international level. One exemplary distortion is associated with rapid short-term capital flow. As several currency crisis experiences in emerging market indicate, rapid short-term capital flows are one of hardest factors to manage by domestic macroeconomic policy even augmented with macro-prudential policy tools such as foreign liquidity managements. With regard to rapid capital flows, the absence of reliable foreign liquidity provision devices has been considered as one of the main distortion factors in international financial market (or architecture) and suggested by exiting literature as a main reason of rapid accumulation of foreign reserves among developing countries since the Asian crisis. This is, if there is no proper foreign liquidity provision mechanism available in emergency, typical policy response of an individual country, particularly a country whose currency is not an internationalized one, will be simply to accumulate foreign reserves. In this regard, the self-protection motivation through foreign reserve accumulation which becomes apparent among developing countries presently seems to be worth more attention and need of establishing dependable foreign liquidity provision device should be addressed as additional financial distortion corrected to restore the global balance.

My another comment is related with international coordination of economic policy which has been pursued to mitigate the adverse effects of the global financial crisis since the first Group 20 Summit held in Washington D.C. in Nov. 2008. This large scale of economic policy coordination is unprecedented at least as far as I know. In that sense, this unprecedented international policy coordination taken so far should deserve more economic investigations with respect to its contributions and limits. In addition, considering that the world economy is more tightly linked due to the globalization and as a result, the effect of domestic economic policy is more easily spilled-over to other regions, studies on economic policy should take its international dimension more seriously and seek the possibility of welfare improvement through policy coordination in more general macroeconomic framework. However, even up to present, literature pays little attention on those aspects of economic policy. In my view, these international dimensions of economic policy should be considered in a more serious way in future researches both of academia and policy circles.