Discussion of

International Reserves and Rollover Risk

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Official Reserves

• **Significant costs:** return differential (Jeanne, 2011)

• **Unclear benefits:**
  1. **Precautionary motive**
     — Obstfeld, Shambaugh and Taylor (2010)
  2. **Dynamic externality** of some sort:
     — Korinek and Serven (2011) and Benigno and Fornaro (2012)

• Reserve accumulation contemporaneously with private capital inflows
This paper

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- Combine elegant modeling with careful numerical execution
  1. defaultable long-term debt (potency of reserves)
  2. exogenous sudden stops (probability of $t = 0$)
  3. endogenous spreads (procyclical gross flows)
Does the model really capture return dominance?

— Risk-neutral pricing of both debt and reserves
  Spread equals risk premium; effectively low cost of reserves

— Two suggestions:

1. Solve the model with exogenous spread between debt and reserves

2. The GE of the model can rationalize high demand for T-bills and their low return
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Comments

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3. Endogenous debt maturity: Is this mechanism equivalent to increasing debt duration in good times (as in Arellano and Ramanarayanan, 2012)?
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Comments cont’d

4 Are results knife-edge in impatience? Need impatience for debt, but not too much for reserves.

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6 What makes “China” different from “Mexico”? 
4. Are results knife-edge in impatience? Need impatience for debt, but not too much for reserves

5. Sudden stop is a black box. What if probability of a sudden stop decreases in income?

6. What makes “China” different from “Mexico”?

7. Can reserves be seized in case of default?
Self-promotion
Itskhoki and Moll (2013)

• In search of the dynamic externality and what makes developing countries different?

• Financial frictions and misallocation: wealth versus ideas

• Reduced-form problem:

\[
\begin{align*}
\max_{\{C_t, L_t, B_{t+1}, \omega_{t+1}\}_{t \geq 0}} & \quad \mathbb{E}_t \sum_{t=0}^{\infty} \beta^t u(C_t, L - L_t) \\
\text{subject to} & \quad C_t + B_{t+1} \leq RB_t + \Theta_t(\omega_t)L_t^\gamma, \\
& \quad \omega_{t+1} = F_t(\omega_t, L_t),
\end{align*}
\]

• Results:

1. Constrained optimal policy: static labor wedge
2. 2nd-best policy: dynamic consumption wedge (savings subsidy)
3. \(L_t\) is subsidized when \(\omega_{t+1}/L_{t+1}\) is low