

“Aggregate Demand Externalities
in a Global Liquidity Trap”
by Luca Fornaro and Federica Romei

Discussion by Alessandro Barattieri

Collegio Carlo Alberto & ESG UQAM

ADEMU Conference “How much of a Fiscal Union for the EMU?”
Madrid, 18-19 May 2017

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- Federica and Luca put in an impressive amount of analytical work to address an important question, providing us with neat insights...and respecting the **KISS principle (Keep It Simple, Sir...)**.
- My Discussion:
 - 1 The paper (shortly).
 - 2 My comments.
 - 3 Three quasi-random thoughts related to the more general topic of this conference.

A Very Promising Paper (1)

- Starting point: In presence of a monetary policy occasionally constrained by a zero lower bound (ZLB), macro prudential policies can improve over *laissez faire* due to an “**Aggregate Demand Externality**” (Farhi and Werning, 2016; Simsek and Korinek, 2016).

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- However, such policies, by lowering the global interest rate, produce an international **“International Aggregate Demand Externality”**, exacerbating the recessions in countries stuck at ZLB.

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- However, such policies, by lowering the global interest rate, produce an international **“International Aggregate Demand Externality”**, exacerbating the recessions in countries stuck at ZLB.
- A non-cooperative financial policy intervention can be inferior to the *laissez faire*, calling for international cooperation. **Very neat insight, very promising paper.**

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- 4 In a global equilibrium, $R^{nc} < R^{lf}$. Non tradable output and welfare lower than in “laissez faire” (P3). (**Key result #1**)
- 5 The problem of a global planner is solved. No country ever enters the ZLB. Switching from non-cooperative policy to cooperation increases output and welfare. (P5, C4) (**Key result #2**)

Comment #1: Motivation

- **International policy coordination (IPC) neither “disregarded”, nor “obscure”**. After the Great Recession, in fact, **IPC put at core of international policy making**:
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 - ▶ (In Europe): European Systemic Risk Board, Single Supervisory Mechanism, etc
- Laying the conceptual foundations for the need for this coordination is relevant and important, especially at times when **IPC is threatened in several policy areas** (trade, climate change, eventually possibly financial stability too...).

Comment #2: Relation to the Literature

- **First paper** to propose the existence of a **rationale for IPC** for financial market interventions in the presence of a global liquidity trap due to an **“international aggregate demand externality”**.

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- Bengui (2014, R&R AEJ:Macro, not cited) “Macro-Prudential Policy Coordination” and Acharya and Bengui (2016, cited) propose a **rationale for the need of the same IPC, but based on different reasons:** pecuniary and terms-of-trade externalities.

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- Perhaps a more **attentive discussion of the relations among these externalities** would be helpful.

Comment #3: The Role of Some Specific Assumptions (I)

Business cycle (perfectly negative) synchronization

- Half of the countries are assumed to receive an high tradable endowment in even period, and a low tradable endowment in the odd period, viceversa for the other half...

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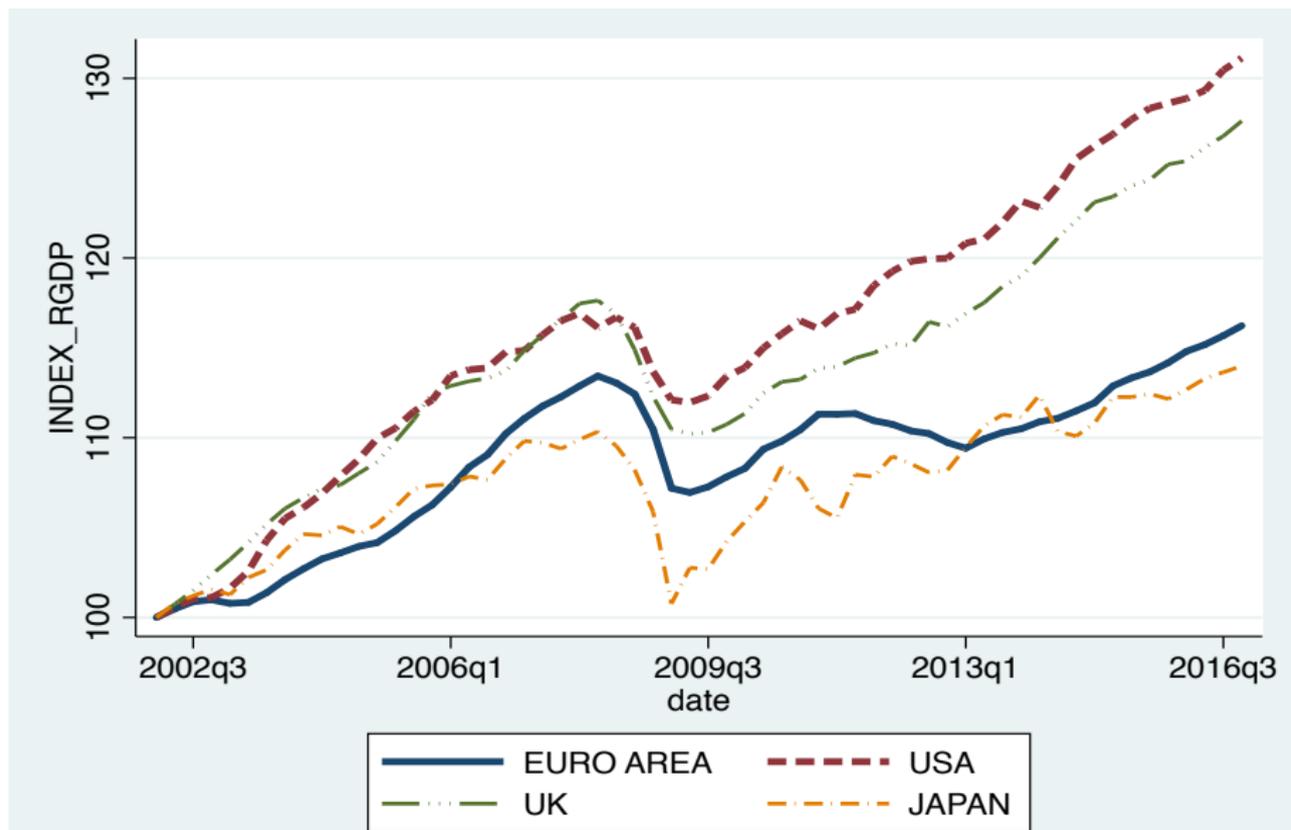
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- Question: If **business cycles move together** (and the need for borrowing is modelled differently) is the **direction of the externality preserved or reversed?** If a country saves in times of boom, It will provide *positive* spillovers in times of global bust (if trade is allowed).

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- **A role for fiscal policy?** Potentially could mitigate negative international aggregate demand externalities...

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- Might it be the same for “Unions” among sovereign states?

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- **Consistent with existing treaties**, this could be a potentially useful **tool to foster growth and employment in Europe...with low risks for inflation**: infrastructures tend to productivity, lowering the inflationary pressures from the implied increase in money supply.

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Suggested Readings on Imbalances: Barattieri (2014, 2016).

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Lessons from "Sport Economics" from professor Wolfgang Schäuble

- Not always the cooperative solution maximizes world welfare...
- Hoping for an highly **non-cooperative** solution on June 3rd ...



Conclusion

- Very nice Paper. Worth reading it. Looking forward to the final version.
- Looking forward also to reading more work by Federica and Luca in the future!
- Thanks!