Discussion of:
The International Transmission of Credit Bubbles: Theory and Policy

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Opening remarks

1. Excellent paper that builds on their work on bubbles, written with similar elegance and clarity, and yields a new perspective on international coordination of fiscal/financial policies

2. Since the product is finished, my comments are literally "academic," which makes it less relevant to focus on model details

3. But for the same reason I will take the liberty of "shooting from the hip" to raise some "big picture" issues and evaluate key modeling assumptions

What is this paper about?

- Highlights three stylized facts of last 25 years: falling interest rates, financial integration, credit cycles

- Raises three questions:
  1. What generates low interest rates and credit cycles?
  2. What are the welfare effects?
  3. Is there a case for policy intervention?

- Extends previous work to a two-country model to study international transmission of credit bubbles

- Identifies two transmission channels: interest rate (negative spillover) and terms of trade (short-run negative, long-run positive)

- Spillovers (externalities) make cooperation desirable

The model

- Two countries produce diff. inputs used to produce consumption and investment goods
- Fixed shares of entrepreneurs (E) and savers (S) live two periods, provide exogenous labor supply
- Financial underdevelopment: Es cannot pledge rental income to creditors => limits credit=> reduces world R
- Bubble is accepted as collateral=> improves E's borrowing capacity at "t" (increasing credit demand and R), but repayment at "t+1" crowds-out investment
- Optimal bubble maximizes long-term welfare by trading-off savings and investment
- "Sentiment" drives bubbles (size, fluctuations, and distribution across countries), and value moves with R

- Transmission channels:
    1. *Via R*: Boom in country A rises R attracts capital from B (lower investment and growth)
    2. *Via TOT*: In short-run, demand for inputs>supply, TOT and RER rise. In long-run, supply adjusts, TOT and RER fall
- Policy analysis: Governments can tax/subsidize with intergenerational transfers (i.e. credit)
    1. Can replicate any DE with bubbles
    2. Unilaterally, governments have strategic incentives
    3. International cooperation dominates Nash

1. Why would creditors take bubbles as collateral but not income and/or assets? (maybe a combination)

2. Why is government more credible than a borrower? (it effectively provides collateral as good as bubbles)

$$R^j_{t+1} \cdot f_{jt} \leq b_{jt+1} + s_{jt+1}$$

3. Since international coordination is not credible, it would be useful to examine outcome without commitment in a dynamic game (as a MPE)

4. Two-period OG prevents self insurance to weaken the effect of the credit constraint

5. How can we tell if the model is empirically plausible/relevant? (can it actually account for the stylized facts the paper starts with?)

   – Better be sure before attempting internationally-coordinated set of intergenerational transfers!

6. How can we impose model discipline on "sentiment"? (common problem in "bounded rationality" setups)

7. Alternative explanations/policies based on collateralized credit with "true" assets:

   a) Optimistic beliefs: Howitt (15), Adam, Marcet & Beutel (15), Boz &Mendoza (14), Bianchi, Boz & Mendoza (12)

   b) Surge in demand for safe assets (globalization with financial underdevelopment, MQRR (09), Mendoza & Quadrini (10))