Discussion of "Unbalanced Financial Globalization" by Capelle and Pellegrino

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financial globalization

Large increase in external assets: from 50% of GDP in 1970 to 300% of GDP in 2020

- Did this improve capital allocation across countries?

Capelle and Pellegrino 2025:

- Neoclassical growth model to assess capital misallocation
- Imperfect substitutability between countries + wedges to explain data on gross flows
- Wedges on both inward and outward flows

Result:

- Both inward and outward openness increased in AE, only outward in EM
- Capital allocation got worse

plan

- context: recent work on imbalances + recent work on neoclassical global economy
- model
- wedges

Context

context

Global imbalances with heterogeneous countries:

- Mendoza, Quadrini, and Rios-Rull (2009): enforcement of contracts
- Caballero, Farhi, and Gourinchas (2008): ability to generate assets
- Mendoza and Quadrini (2010): US leverage before 2008 driven by external liabilities
- Mendoza and Quadrini (2024): EM have accumulated large stocks of reserves, AE have massively issued public debt over the last 50 years

Neoclassical growth and the global economy, starting with Lucas (1990)

- Kleinman, Liu, and Redding (2023): convergence with imperfect trade in goods and assets, iceberg costs and constant-elasticity substitution in both
- Pellegrino, Spolaore, and Wacziarg (2021): wedges and gravity

Model

simple model

Two periods, two countries, AK production, imperfect substitution of assets

- country i's saver:

$$\max_{c_{i1}, c_{i2}, a_i} (1-\sigma)\log(c_{i1}) + \sigma \log(c_{i2})$$

$$\text{s.t. } c_{i1} = \sigma^{-1} e_i - a_i \text{ and } c_{i2} = R_i a_i$$

- country i's firm: $y_i = z_i k_i$, where $k_i = \sum_{j=1,2} a_{j \to i}$
- country i asset split: $a_i = a_{i \to i} + a_{i \to j}$

$$\frac{a_{i \to i}}{a_i} = \frac{z_i^{\beta} \cdot k_i}{z_i^{\beta} \cdot k_i + (z_j \cdot \tau_{i \to j})^{\beta} \cdot k_j} \text{ and } \frac{a_{i \to j}}{a_i} = \frac{(z_j \cdot \tau_{i \to j})^{\beta} \cdot k_j}{z_i^{\beta} \cdot k_i + (z_j \cdot \tau_{i \to j})^{\beta} \cdot k_j}$$

equilibrium and static optimum

Conditional on $\{a_i\}_{i=1,2}$, maximize output: $k_2 = e_1 + e_2$ and $k_1 = 0$ optimal assuming $z_1 > z_1$

Equilibrium:

- log utility: $a_i = e_i$
- under assumptions on $\{\tau_{1\to2}, \tau_{2\to1}\}$ and $\{z_i\}_{i=1,2}$, capital is

$$k_1 = z_2^\beta \cdot \left(\frac{e_1}{z_2^\beta - z_1^\beta \cdot (\tau_{2\to1})^\beta} - \frac{e_2 \cdot (\tau_{1\to2})^\beta}{z_1^\beta - z_2^\beta \cdot (\tau_{1\to2})^\beta} \right)$$

$$k_2 = z_1^\beta \cdot \left(\frac{e_2}{z_1^\beta - z_2^\beta \cdot (\tau_{1\to2})^\beta} - \frac{e_1 \cdot (\tau_{2\to1})^\beta}{z_2^\beta - z_1^\beta \cdot (\tau_{2\to1})^\beta} \right)$$

comparative statics

Letting $\beta = 1$ for simplicity,

$$y_{\text{global}} \Big| a_1, a_2 = z_1 k_1 + z_2 k_2 = z_1 z_2 \cdot \left(\frac{e_2(1 - \tau_{1\to 2})}{z_1 - \tau_{1\to 2} \cdot z_2} + \frac{e_1(1 - \tau_{2\to 1})}{z_2 - \tau_{2\to 1} \cdot z_1} \right)$$

Total output increases in $\tau_{1\to 2}$ and decreases in $\tau_{2\to 1}$ if $z_2 > z_1$

- facilitating outward flows out of the more productive country is $\downarrow$
- facilitating inward flows into the less productive country is $\downarrow$

Wedges

what kind of assets?

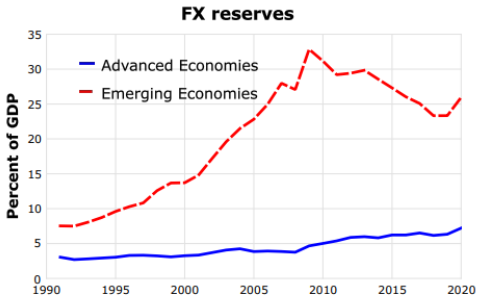
Wedge accounting is informative conditional on model

- neoclassical growth + asset demand system $\Longrightarrow$ wedges capture frictions
- can do counterfactuals

Questions:

- is demand for AE-issued assets driven by neoclassical forces?
- is supply of AE-issued assets driven by country size?

reserves and public debt



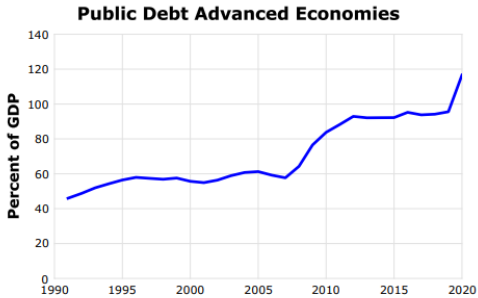


Figure: Mendoza and Quadrini (2024)

other potential drivers of asset demand and supply

Global risk

- payoffs that countries produce have different correlation with global output/consumption
- growing in size does not lead to being able to issue assets with countercyclical returns
- global risk is important (Pellegrino, Spolaore, and Wacziarg (2021) incorporates it?)

Convenience/mandates

- inelastic demand for some types of assets
- nested demand system?

Financial depth and intermediation capacity

- growth in size does not lead to growth in capacity to provide financial services

Thanks!

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