Discussion of

International Reserves and Rollover Risk

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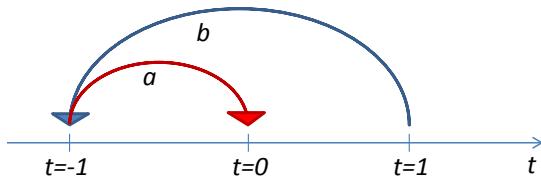
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Official Reserves

- **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)

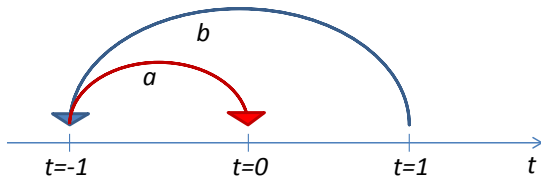- Reserve accumulation contemporaneously
  with private capital inflows

- A clear argument for reserves:

  Reserves make financial markets more complete

This paper

- A clear argument for reserves:

  Reserves make financial markets more complete

- 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)

Comments

1 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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3 Endogenous debt maturity: Is this mechanism equivalent to increasing debt duration in good times (as in Arellano and Ramanarayanan, 2012)?

Comments cont'd

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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:

$$\max_{\{C_t, L_t, B_{t+1}, \omega_{t+1}\}_{t \geq 0}} \mathbb{E}_t \sum_{t=0}^{\infty} \beta^t u(C_t, L - L_t)$$

$$\text{subject to} \quad C_t + B_{t+1} \leq RB_t + \Theta_t(\omega_t) L_t^{\gamma},$$

$$\omega_{t+1} = F_t(\omega_t, L_t),$$

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