Discussion of "Exorbitant Privilege and Exorbitant Duty" by Gourinchas, Rey and Govillot

Deputy Governor Karolina Ekholm
Should we worry about global imbalances?

- Not necessarily if the exorbitant privilege hypothesis is correct.
- Lack of justification for ROW’s willingness to hold low-return US assets weakness of hypothesis.
- Present paper offers justification in terms of insurance against global distress.
- Consistent with observed worsening of US net foreign asset position during crisis.
  - Appreciation of USD evidence against “standard” adjustment.
Twofold contribution

- **Empirical:**
  - Extend and improve data on US external balance sheet structure and returns.
  - Document exorbitant privilege in normal times and exorbitant duty in times of stress.

- **Theoretical:**
  - Develop model to explain these phenomenon.
Overall comments

- Model generates at least qualitatively observed features of the US external position as the optimal outcome.
- On what grounds should model be judged to be true/false?
  - Important to understand whether US CA deficit is destabilizing or stabilizing factor in the world economy.
Comment on empirical section

- How is transfer pricing dealt with?
  - 30-40 percent of trade between related parties.
  - Bernard, Jensen and Schott (2006):
    "Back-of-the-envelope calculations suggest that pricing responses to tax rate differences across countries led to... a $15 billion increase in the merchandise trade deficit in 2004."
Model based on several crucial assumptions

- Difference in size
- Difference in risk aversion
- Disaster risk
- Difference in default risk

And the main culprit is…?
Some further comments

- Difference in country size and presence of disaster risk assumptions that are easy to justify.
- What about difference in risk aversion and default risk?
  - Empirical evidence of the former?
  - Latter exogenous factor or endogenous outcome?