BANK FOR INTERNATIONAL SETTLEMENTS

Discussion of "China's Imbalances: Trade Integration in a Dynamic General Equilibrium Model" by Alessandria, Choi, and Lu

by Raphael Auer (BIS & SNB) at the conference on "Exchange Rates and External Adjustment," Swiss National Bank, International Monetary Fund, and IMF Economic Review, Zurich, June 24-25 2016

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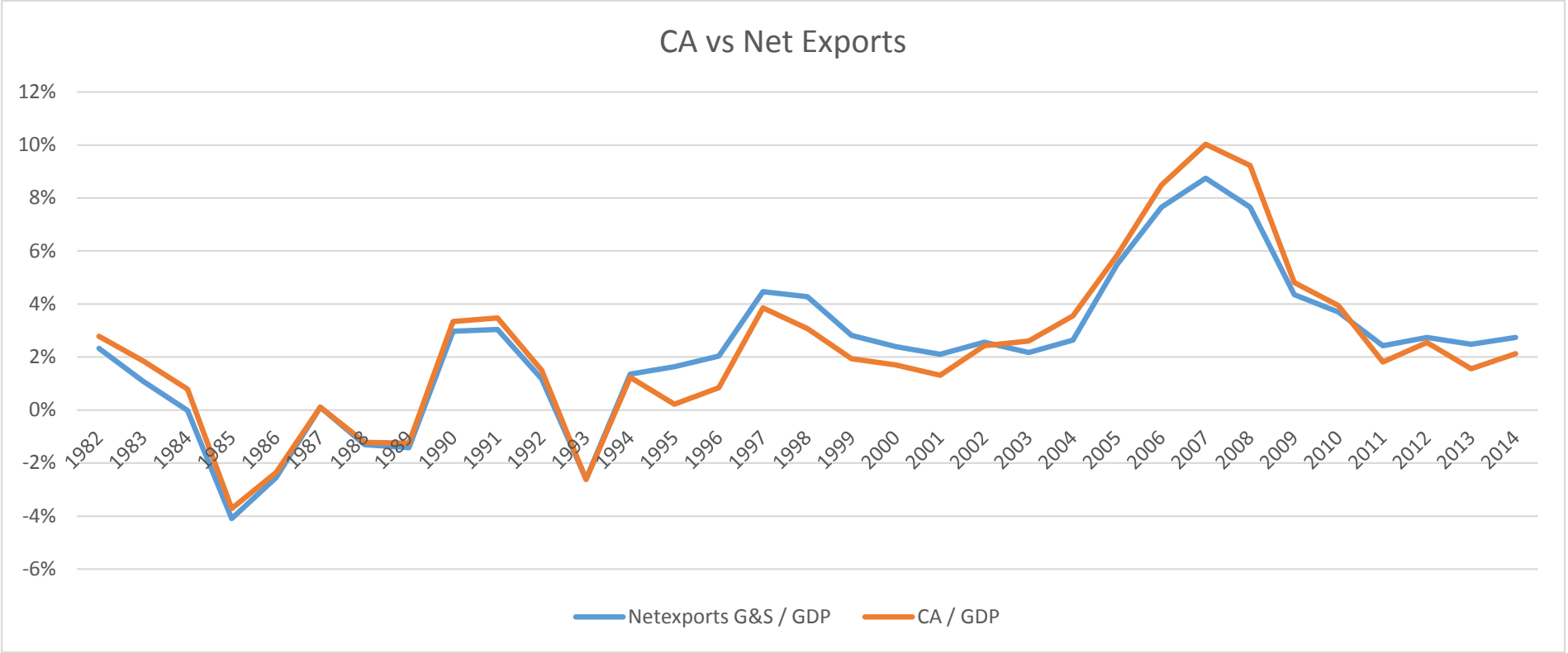
China's Imbalances: Trade Integration in a Dynamic General Equilibrium Model

- A dynamic export participation model following Alessandria and Choi (2007 and 2015)
- Explains the dynamics of Chinese net trade with the forward-looking decision to invest in export market access, which depends on country-specific shocks to preferences, productivities, and trade costs
- Results are reminiscent of Beachhead effect: temporary reduction in relative Chinese export costs (and also reduction in global trade costs) has spurred investment in market access and given rise to CA surplus during transition

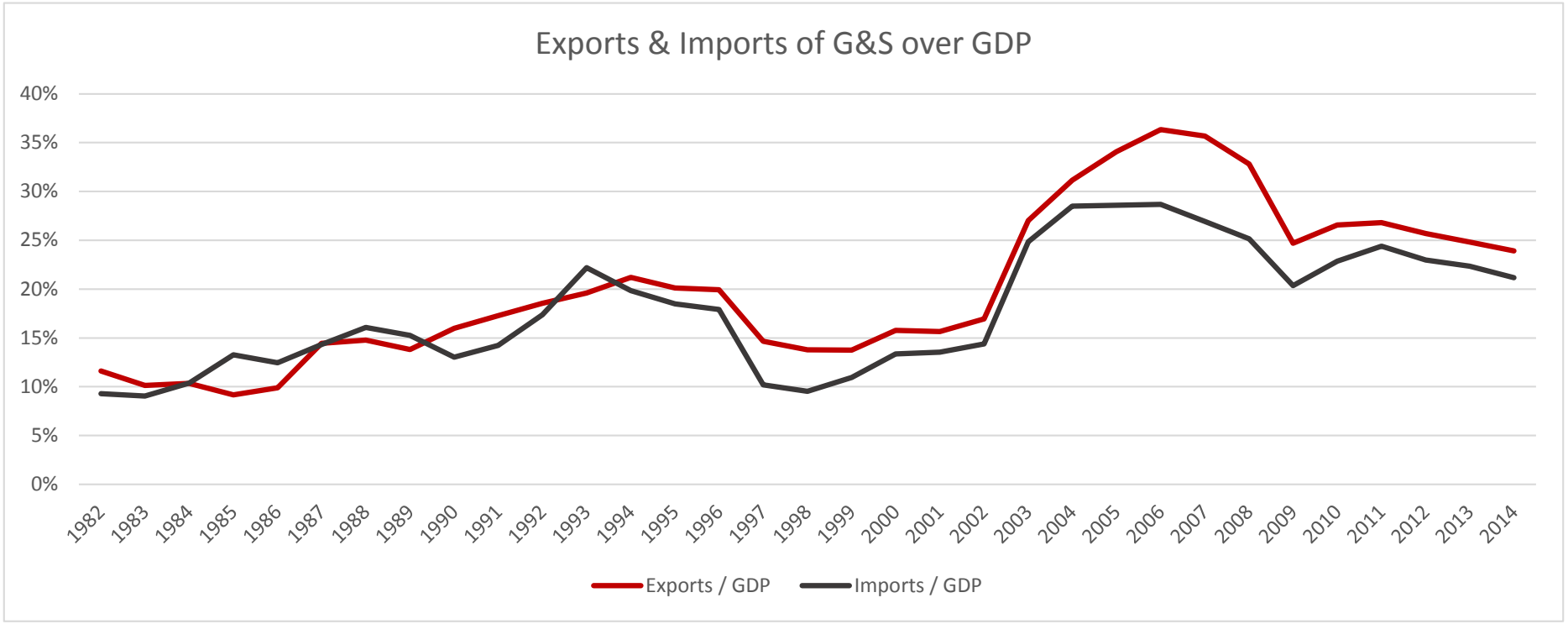
Some Comments

- Backed-out shocks are result of model's structure: parameters and allowed shocks
- Need to check whether the resulting shocks are consistent with salient patterns of the data:
  - Is the Chinese CA driven by net exports (instead of other international income) & the evolution of exports and imports consistent with the argument? **yes**
  - Do measurable proxies for trade costs correlate with the uncovered shocks? **we need more evidence for the precise mechanisms**
  - Which important shocks are not allowed for? **interventions**

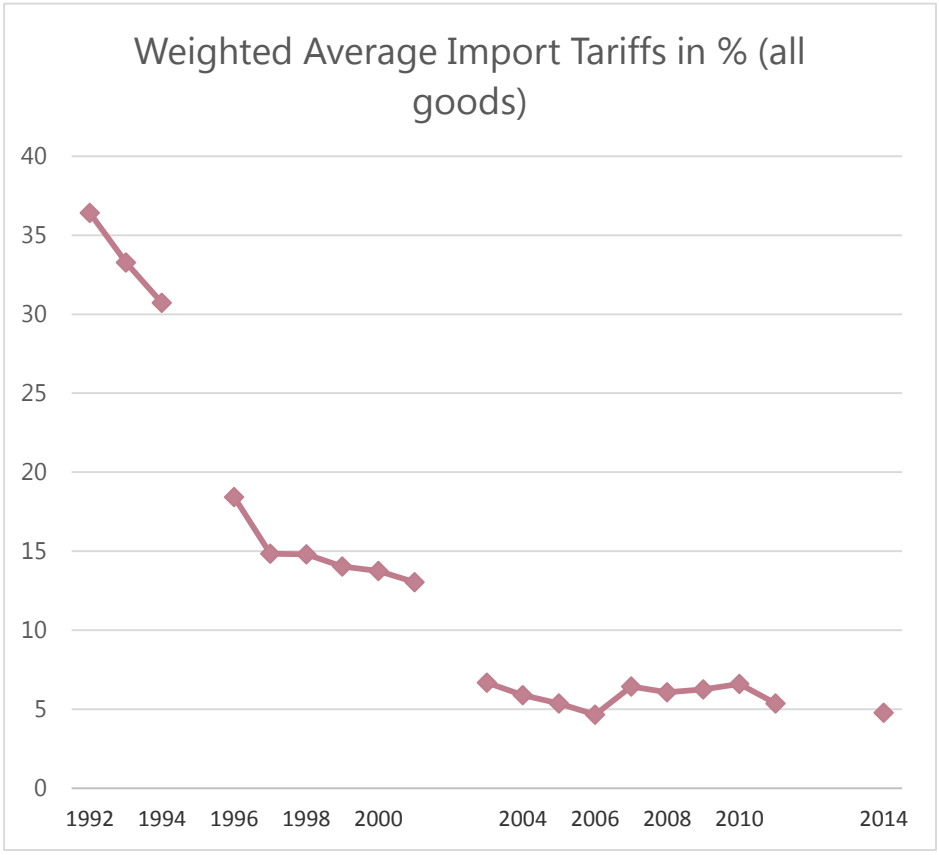
CA and Net Exports of Goods & Services

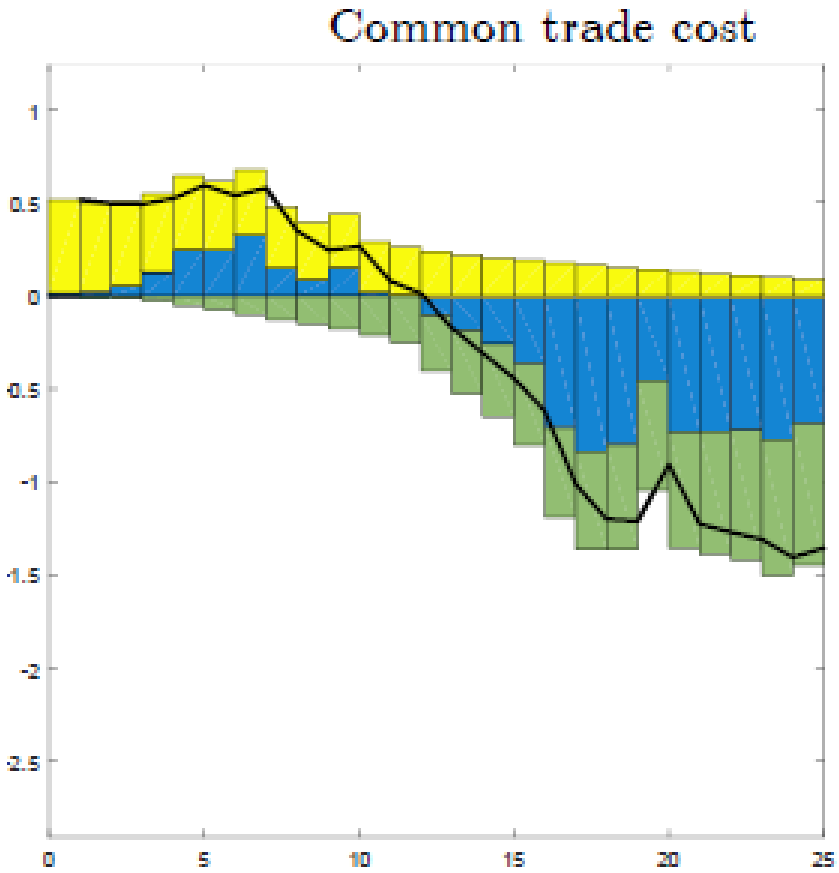


Export and import dynamics



Import tariffs declined strongly



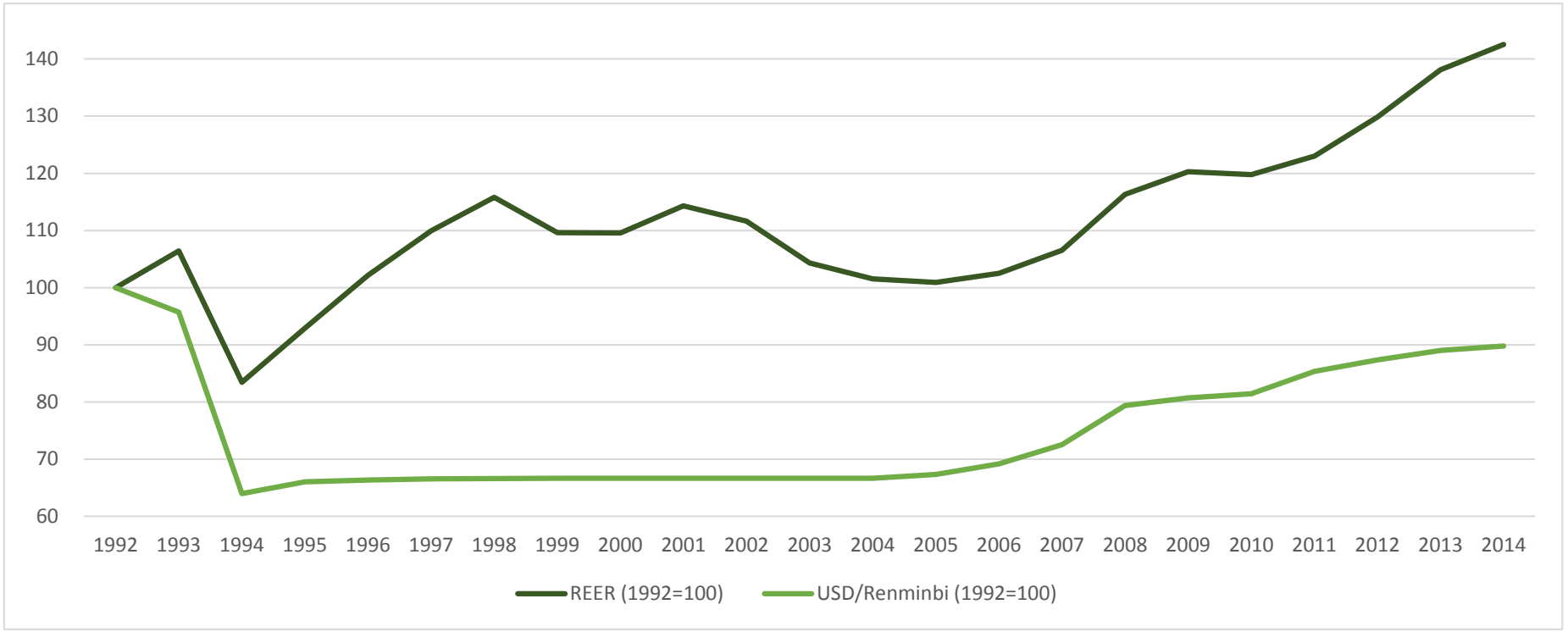


Can trade costs explain CA dynamics?

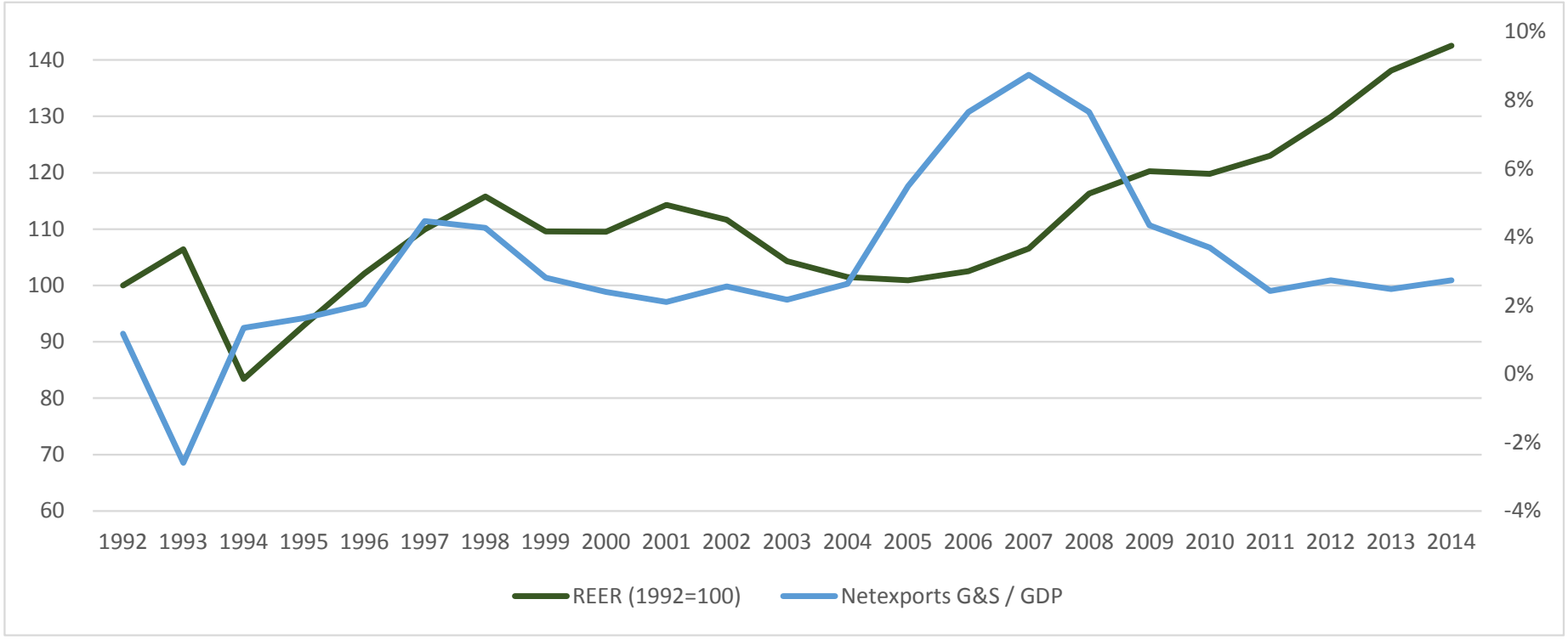
- In the model, temporary CA surplus arises either due to relatively lower trade costs…
  - Is it likely that foreign tariffs declined more than Chinese ones? Average Chinese import tariffs need to be compared to average tariffs on Chinese exports
  - WB doing business indicators don't signal significant changes in fixed costs of exporting vs. importing.
- …or due to a uniform decrease in trade costs (for the smaller country that gains more from future access).
  - Not clear how this prediction goes through in a multi-country world (in 2 country world, need to model internal transportation cost in RWO)
  - Timing (liberalization ends in 2003)?

What is the role of the Chinese exchange rate policy?

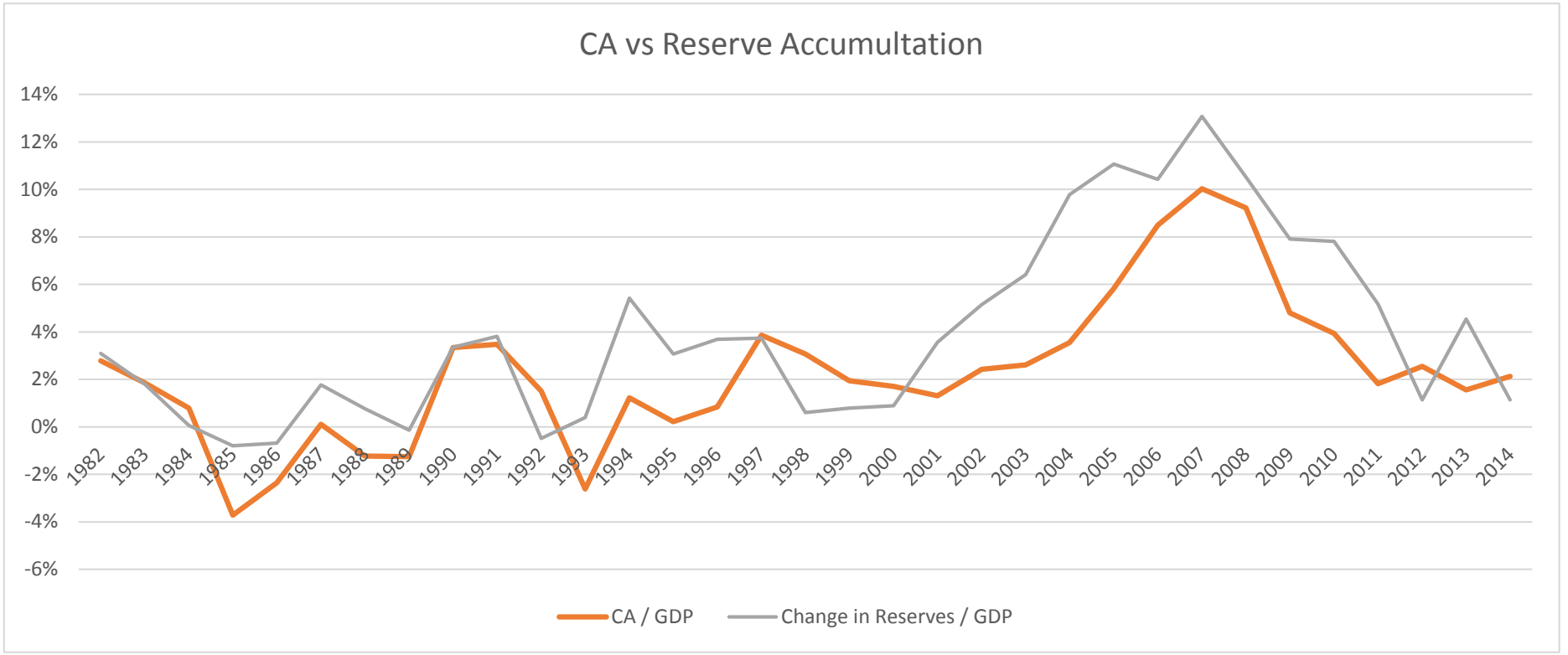
The renminbi was fixed to USD from 1994-2005 and revalued thereafter…



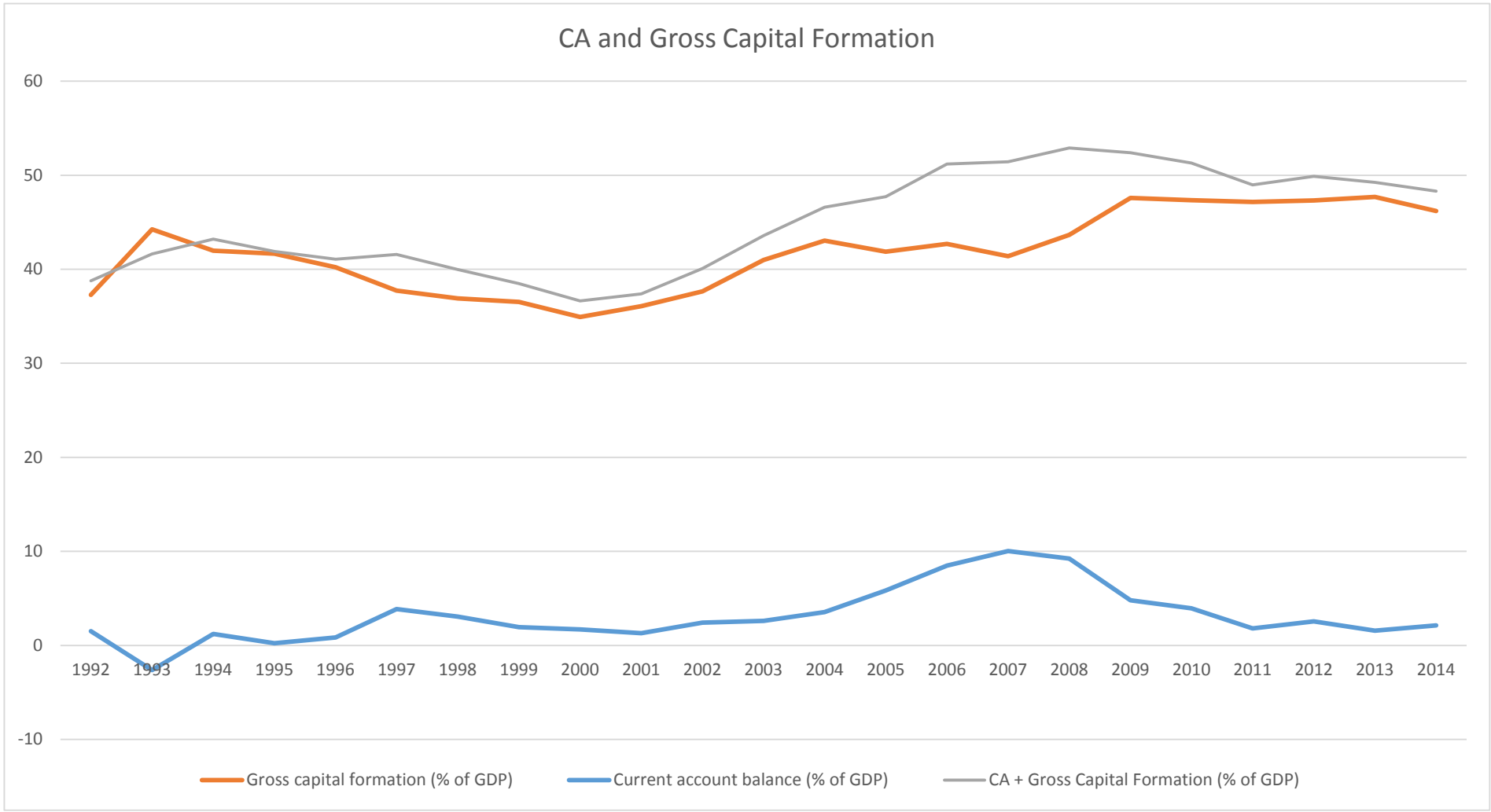
…this could be argued to drive net exports…



…but most importantly, reserve accumulation was actually larger than the CA surplus.



(There was no upfront investment boom, rather an ex-post one)



Minor

- What is the precise role of valuation effects?
  - Relation between NFA and CA only growth & valuation channel?
  - role of the bond adjustment cost?
- Fewer shocks make interpretation of results easier. How good is the fit of the model if we only had one absolute and one variable relative variable trade cost shock? What is added by the richer shock structure?
- Incomplete description of the model: no labor market clearing, unclear which shocks are depicted in which graphs etc.

Conclusion

- Very interesting application of a rich real microstructure examining beachhead effects in dynamic equilibrium
- China important application for this kind of model
- Main comment: need to show that the shocks are reasonable & not artefact of policy
  - Need to model Chinese exchange rate interventions which are larger in magnitude than CA surplus (difficult in this mostly real model)
  - There are good proxies for trade costs out there and the authors need to show how the computed shocks compare to those proxies