This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: NBER International Seminar on Macroeconomics 2009

Volume Author/Editor: Lucrezia Reichlin and Kenneth West, organizers

Volume Publisher: University of Chicago Press

Volume ISBN: 0-226-70750-4 (paper)

Volume URL: http://www.nber.org/books/reic09-1

Conference Dates: June 12-13, 2009

Publication Date: June 2010

Chapter Title: Comment on "The Feldstein-Horioka Fact"

Chapter Author: Philip R. Lane

Chapter URL: http://www.nber.org/chapters/c11911

Chapter pages in book: 122 - 124

Comment

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The core of the seminal contribution by Feldstein and Horioka (1980) was to ask if a country saves more, how much of that extra saving is retained in domestic investment rather than sent overseas? Feldstein and Horioka interpreted the high cross-sectional correlation between savings and investment as indicating that capital was largely internationally immobile: if a country saved more, its domestic capital stock would increase. However, the subsequent literature quickly established that other interpretations were possible and that the high observed correlation could also be consistent with perfect capital mobility. In particular, common shocks drive savings and investment in the same direction for all countries such that the observed correlation will be high if common shocks dominate idiosyncratic shocks.

The contribution of "The Feldstein-Horioka Fact" by Domenico Giannone and Michele Lenza is to provide an empirical framework that establishes the relative contributions of global and country-specific shocks in driving savings and investment rates. Within the Feldstein-Horioka tradition, this is a clear methodological innovation.

It is important to be clear about terminology in this area. We may define a symmetric shock as one that affects all countries in the same way (savings and investment respond identically in all countries), whereas an asymmetric shock is one that generates differential responses between savings and investment across countries. Clearly, a current account imbalance can arise only in the event of an asymmetric shock. While a country-specific shock is by definition asymmetric, Giannone and Lenza do not assume that global shocks are necessarily symmetric. In particular, different economic structures mean that a global shock may generate current account imbalances if the global shock has an asymmetric impact on different countries.

   To understand the possible asymmetric impact of a global shock, consider the following decomposition of country j's savings rate:

$$S_{jt} = S_t^{\text{SYMM}} + S_{jt}^{\text{ASYMM}},$$

$$S_{jt}^{\text{ASYMM}} = (\delta_j - \delta_W)\text{GLOB}_t + S_{jt}^{id}.$$

The asymmetric component of the savings rate may be driven by a country-specific term S_{jt}^{id} or by a differential response to the global shock, as captured by the $(\delta_j - \delta_W)\text{GLOB}_t$ term. In terms of the shocks identified by the authors, a global investment boom will have asymmetric effects on exporters of capital goods relative to importers of capital goods. Similarly, a shift in the world interest rate will have a differential impact on creditor nations versus debtor nations. Accordingly, it is not too surprising that "global" shocks can help to explain current account behavior, since it is difficult to list truly symmetric shocks that affect all countries in identical ways.

   One goal of Giannone and Lenza is to investigate whether the current account response to idiosyncratic shocks has shifted over time. However, increasing capital mobility should also lead to a shift in the current account response to asymmetric global shocks, but this is not permitted by their methodology. Accordingly, the results presented by the authors are incomplete in this respect.

   In overall terms, the paper can be viewed as a useful contribution to the Feldstein-Horioka literature, especially in emphasizing that global shocks can have asymmetric effects. However, the broader question is whether this is a useful framework for thinking about current account behavior, and I am skeptical on this front.

   First, it is clear that there are long-term trends in external positions, and a major focus of international macroeconomics research should be on understanding the driving forces behind these long-term imbalances rather than just focusing on transitory shocks. Persistent differences in demographic structure, levels of public debt, and levels of GDP per capita can help to explain these trends (Lane and Milesi-Ferretti 2002). In addition, differences in the level of financial development can also generate chronic imbalances (Caballero, Farhi, and Gourinchas 2008; Mendoza, Quadrini, and Rios-Rull 2009). In relation to assessing the impact of increased capital mobility, an important question is the extent to which this has allowed long-standing structural differences across economies to translate into large nonzero net international investment positions.

Second, even in relation to temporary shocks, there is no particular reason to limit attention just to the joint behavior of savings and investment. In particular, a full general equilibrium model can allow savings and investment rates to be endogenously determined, with possible frictions in cross-border capital mobility explicitly modeled. To this end, an exciting strand of current research is developing general equilibrium models with incomplete financial integration, in which cross-border financial portfolios are endogenously determined and the response of the current account to a given shock depends on the structure of a country's international balance sheet (Devereux and Sutherland [2007] and Tille and van Wincoop [2007] are two examples). While still in an early stage of development, this class of models promises to provide an enriched interpretation of current account behavior under different degrees of international capital mobility.

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