Persistent Appreciations and Overshooting: A Normative Analysis

Discussion by

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Discussant: Gita Gopinath
Harvard and NBER

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- What should the intervention be?
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- What should the intervention be?
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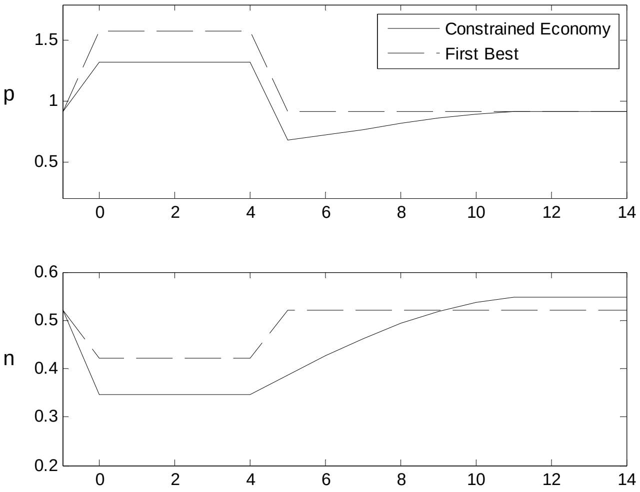
- What causes the real exchange rate appreciation?
- Not much to say about this

Previous Explanations for why Intervene?

- Learning-by-Doing, Knowledge Spill-overs, Traded sector source of growth. Krugman (1987).
    - Comparative Advantage via learning by doing. Temporary over-valuation can lead to permanent losses because these sectors lose their competitiveness. Growth from the tradable sector. Real ER appreciation makes you specialize in the less dynamic sector.
- Financial Frictions: Excessive relative price movements. Hausmann and Rigobon (2002).Effect on real wages.

Mechanism

- Financially constrained Exporters: Can save, but cannot borrow. $a(s^t) \geq= 0$.
- Irreversible Destruction: Cannot keep a factory idle. Need to hire one unit of labor to keep it running. Fixed cost of setting up unit.
- General Equilibrium Effect: Labor market clearing determines wages.
$$n(s^t) + c_N^{s^t} = 1 \quad (1)$$
- Source of RER appreciation: Positive Taste Shock for consumption. Reverse with positive probability.
- Pecuniary Externality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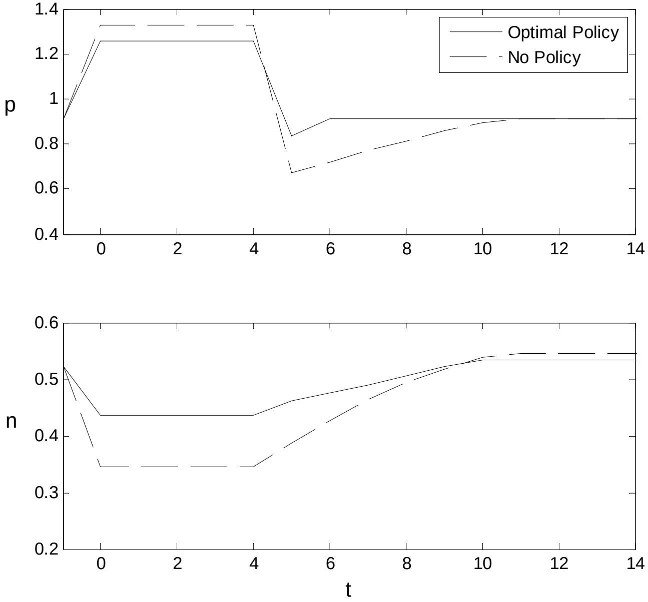

Figure 5: Optimal Policy

Appealing Features

- Benevolent government, not trying to favor exporters will still want to intervene.
- Ex-ante versus Ex-post intervention. The duration of appreciations matter.

Some Questions

- Restrictions on policy instruments. These instruments cannot deliver the first best
- If could transfer resources between the household and export sector then can arrive at the first best.
- Excluded policy instruments seem as plausible as the one of taxing consumption.
- Encourage FDI. Less financially constrained.

Some Questions

- Source of RER movement is important to understand. When will financial frictions be important.
- Capital Flows.
- Aid Flows: Rajan and Subramanium. Traded sector which is the source of growth negatively effected.
- Resource Curse.
- Productivity Improvements.

To Conclude..

- Very interesting paper on an important question. Rich analysis
- More generally applicable to multi-sector models with asymmetric shocks and financially constrained sectors.
- Calls for more work on sources of RER appreciation, evaluate the importance of financial frictions.