Comment on: Modeling the impact of the Global Financial Crisis on World Trade Warwick J. McKibbin Andrew Stoeckel

by Gordon Menzies, UTS

Outline

- The value of this kind of modeling
- The general challenges of modeling the GFC
- Particular issues with this paper

The value of this kind of modeling

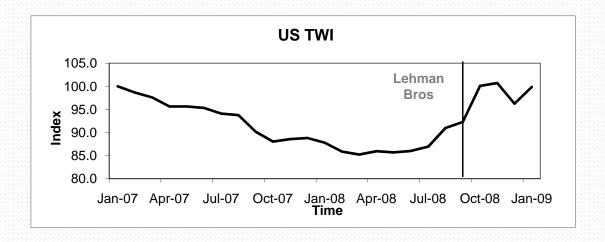
- At one interpretable end of the modeling continuum
- Coherence of 'big picture' views
 - European fiscal expansion and exports
 - Interest rates and fiscal expansion
- Explicit causes for everything
 - Bursting of housing
 - Rise in equity risk premium
 - Rise in discount rate for households
 - (+ policy responses)

Challenges of modeling the GFC

- Institutions and financial detail are really important for the GFC but they are not in models
- Key drivers are exogenous (eg. risk premia) and not well understood – problem of circularity

Particular issues with this paper

 What about the safe haven status of the \$US and the reverse for Australia?



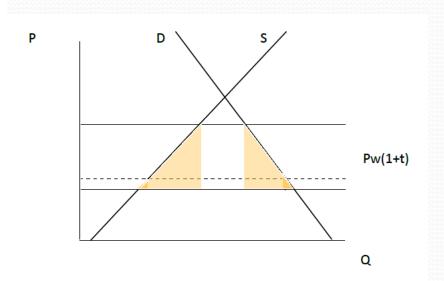
- Where are the exchange rates?
- The GFC is history now. Where is the comparison to actual outcomes?
- Lucas critique really bites (at last)

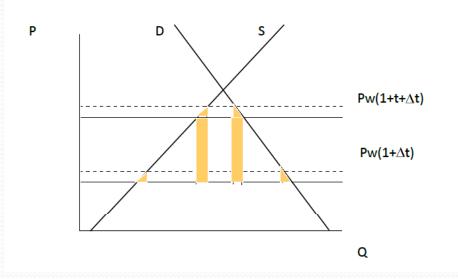
Do small trade distortions matter?

- GFC has caused a small increase in protection
- But paper simulates a large increase in protection
 - Why? What is paper about ?
 - 'a plausible change in protection' pg. 25
 - 'a resort to wide spread protection would make matters much worse... 10 percentage points' pg. 30

Do small trade distortions matter?

• Is deadweight loss linear in the tariff rate?





Do small trade distortions matter?

- More realistic distortions imply a small effect
- An interesting policy question is when welfare effects of tariff changes become 'large'
- Dixon and Rimmer (2010), "Optimal Tariffs: Should Australia cut automotive tariffs unilaterally?" Economic Record, 86, 143-161