Accepted Manuscript

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Constantino Hevia, Luis Servén

PII: S0304-3878(18)30623-0

DOI: 10.1016/j.jdeveco.2018.05.011

Reference: DEVEC 2237

To appear in: *Journal of Development Economics*

Received Date: 24 November 2016

Revised Date: 16 March 2018

Accepted Date: 8 May 2018

Please cite this article as: Hevia, C., Servén, L., Assessing the degree of international consumption risk sharing, *Journal of Development Economics* (2018), doi: 10.1016/j.jdeveco.2018.05.011.

Assessing the degree of international consumption risk sharing☆

Constantino Hevia

Universidad Torcuato Di Tella

Luis Servén

World Bank

Abstract

This paper examines the extent of risk sharing for a group of 50 industrial and developing countries. The analysis is based on a model of partial consumption insurance whose parameters have the natural interpretation of coefficients of partial risk sharing even when the null hypothesis of perfect risk sharing is rejected. Results show that rich countries exhibit higher degrees of risk sharing than developing countries, and that the gap has widened over time. Other things equal, the degree of risk sharing is higher in smaller, more financially-open economies and in those possessing flexible exchange rate regimes.

Keywords: Incomplete risk sharing, Financial globalization.
JEL classification: E21; F36; F41

1. Introduction

A considerable analytical and empirical literature has been concerned with the extent of consumption risk sharing across countries. The relatively high sensitivity of aggregate consumption to domestic income shocks – equivalently, the low degree of comovement of aggregate consumption across countries – is one of the major puzzles in international macroeconomics (Obstfeld and Rogoff, 2001). In recent years, it has attracted renewed interest due to the growing degree of financial integration of economies across the world. The argument is straightforward: if financial markets are complete – in the sense that available assets span all idiosyncratic risks – the ratio of the marginal utilities of

☆Corresponding author: Constantino Hevia, Universidad Torcuato Di Tella, Av. Pres. Figueroa Alcorta 7350, C1428BCW Buenos Aires, Argentina. E-mail: chevia@utdt.edu. We thank Aart Kraay, Alex Werner, and seminar participants at IMF and UAM for useful discussions, and Vivian Norambuena for excellent research assistance. This work was supported by the World Bank's Knowledge for Change and Strategic Research programs. The views expressed here are only ours and do not necessarily reflect those of the World Bank, its Executive Directors, or the countries they represent.