Global Warming and Global Diversification

Kazutaka Takechi
Hosei University

Abstract

This study investigates the implications of international portfolio diversification for global warming. By comparing economies under optimal international diversification and financial autarky, we show that positive productivity shocks in an emission-intensive country amplify the impact of the shock on global emissions more under diversification than under autarky. Because wealth gains are shared with foreign investors under international portfolio diversification, increases in domestic goods demand and home wealth are lower than under autarky. This attenuation of demand and wealth effects leads to a lower real exchange rate deviatoin and a larger increase in relative investment and labor supply, thereby magnifying the impact of the shock on global emissions. Overall, international portfolio diversification highlights the role of relative price and wealth effects in shaping the global environmental consequences of country-specific productivity shocks.