Comments on

The Real Effects of Capital Controls:

Credit Constraints, Exporters and Firm Investment

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by

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USC and the NBER

This is an interesting paper on an important topic.

The paper evaluates the effects of capital controls on firm-level stock returns and real investment using data from Brazil.

A two stage investigation:

1. **The authors present results of a case study focusing on a two-day window of the stock returns after a policy change dealing with CC.**
2. **They also look at the before-after investment picture for two and three year windows around 2008 and 2009.**

Main results

There is a significant decline in cumulative abnormal returns for Brazilian firms following the imposition of capital controls in 2008-2009, consistent with an increase in the cost of capital.

Investment remains relatively unchanged in the two and three year windows around the 2008 date.

Large firms and the largest exporting firms are relatively unaffected by the controls. Exporting firms saw a statistically significant rise in their investment rates.

Small and non-exporting firms experienced a significant fall in their investment rates. Firms with an above median score for external finance dependence saw a fall in their investment rate

while firms that were less dependent on external finance increased investment.

Comments: I have several questions about the event study methodology used in this paper, and the ability to identify the link between capital controls and firms' performance.

- **The market reaction may be short-lived**, over-reacting to policy announcements.
- **What is the counterfactual? The announced policies may react to exogenous shocks that are not controlled in the paper. These shocks may induce the adjustment more than the capital controls.**
- The same concern applies to the before-after investment picture for two and three year windows around 2008 and 2009.

Were the changes the outcome of CC, or of higher volatility of TOT, higher volatility of domestic shocks, etc…

- Another recent paper attempted to control for the counter factual, coming with different results:

Capital controls in Brazil – Stemming a tide with a signal?

by Jinjarak, Noy, Zheng

Journal of Banking & Finance 2013

- They focus on Brazil's five changes in its capital account regime in 2008–2011.
- Using the synthetic control method, they construct counterfactuals (i.e., Brazil with no policy change) for each of these changes.

- They find no evidence that any tightening of controls was effective in reducing the magnitudes of capital inflows, but observe modest and short-lived success in preventing further declines in inflows when the capital controls were relaxed.
- They hypothesize that price-based capital controls' perceptible effect is in signaling the government's policy. Brazil left-of-center government's willingness to remove controls was perceived as an indication that the government was not as hostile to the international financial markets as many expected it to be.
- **Jinjarak et al. 2013 JBF is consistent with other studies - the effects of capital controls may be short lived.**

- **Frequently, problematic domestic policies hinder better performance. The challenges facing Brazil are less CC, and more its internal distortions:**

  Debt overhang [public; sizable & growing private dollar debt],

  Fiscal excesses and low saving base;

  Mishandling its energy sector: Petrobras

  Distorted banking system, dominated by states banks - Bendex and the like.

  Under-investment in infrastructure and human capital, etc.

  Understanding the marginal impact of CC on the growth challenges of Brazil remains an important topic.


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