DOMESTIC AND MULTILATERAL EFFECTS OF CAPITAL CONTROLS IN EMERGING MARKETS
(Pasricha, Falagiarda, Bijsterbosch, Aizenman)

Discussion

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Main question

- Summed up in title: What are the domestic and multilateral effects (effects on other countries) of capital controls?

- General motivation: Effectiveness of cross-border capital flow controls important in the context of the impossible trinity

- Important and relevant: ``Currency Wars'' due to QE in the US and more recently EMU

Methodology: new index

- New index of capital controls: ``...count policy changes separately by asset class and price, quantitative or monitoring type and then weigh(t) the changes by the share of the country's total international assets or liabilities that the measure is designed to influence.''

- Example: Restriction on FDI outflows is weighted by the share of FDI assets in total international assets of the country

Methodology: new index

- Idea: more important assets/liabilities receive more weight...more likely to see effects
- Improves cross country comparability
- From daily data, aggregated to quarter

Methodology

- Panel VAR
- Capital controls are endogenous decisions, so clearly determined by past values of domestic and international macro variables
- Also, trinity suggests joint determination of other key variables: the spot USD exchange rate, the absolute value of the covered short-term (three-month) interbank interest rate differential, capital flow (focus on non-FDI capital flows)
- Exogenous global drivers

Main findings

- Limited or no evidence of the domestic effectiveness of capital controls
- Strong evidence of effects on other countries (through channels such as exchange rates, interest rates and capital flows)
- Multilateral effects more important for BRICs
- Multilateral effects have become more important over time for non-BRICs

Praise

- Nice, solid paper; enjoyed reading it
- Very careful construction of CCA measure
- Comments will mainly focus on trying to improve my own understanding of the paper (and hopefully of others in the room!)

COMMENTS ABOUT CCA MEASURE

Comments: 1

- One way of thinking: the measure of capital controls is a dummy variable $D_i = 1$ if asset (liability) i is affected; *weighted by the portfolio share of asset (liability) i, α_i, in the wealth of the country:* $\sum_i \alpha_i D_i$

- Clearly, the α_i s are endogenous portfolio choice variables determined by excess returns, betas etc. on these different A/Ls

Comments: 1

- Wondering if this weighting with α_i s is an issue – unless you carefully account for the excess returns etc. on those different assets/liabilities in the VAR system itself

Comments: 1

- Why is it an issue?
- Long literature on determinant of excess returns, valuation effects etc. on country assets/labilities (see, for example, series of papers by P.O. Gourinchas and co-authors)
- These returns related to current account deficits or surpluses (i.e. net capital flows)
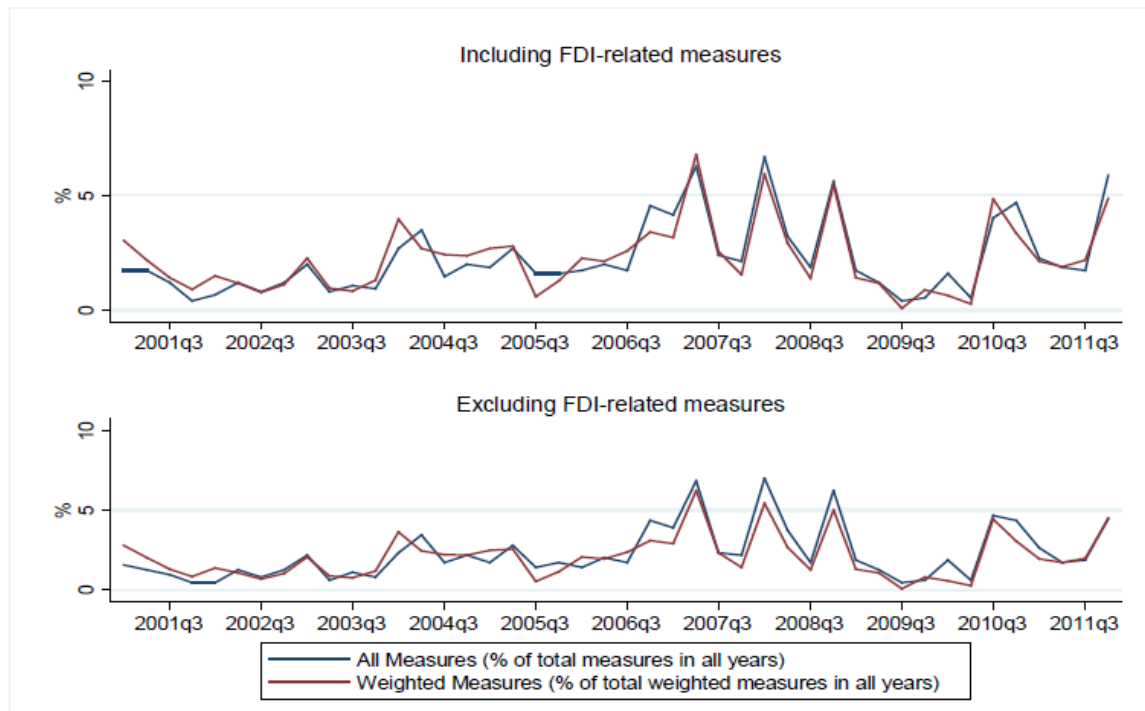
Comments: 1

- Note that the lagged weighting scheme, which lags these portfolio weights by 1 year, does not take care of this particular issue (it is meant to deal with the endogeneity of the portfolio weights to the CCAs)

Comments: 2

- Do you get much bang for your buck?

Figure 1: Weighted and un–weighted changes in capital controls follow similar patterns over time

(a) Quarterly Frequency

Comments: 2

- Graph makes sense: why would policy makers introduce controls for stuff that does not matter?

- Even if CCAs on different asset classes are introduced, as long the important ones for that country are being targeted, the weighted and unweighted measure should look similar

- Reassuring to know policy makers are smart, or, *is it worth the weight*?

Comments: 3

- ``A change in capital controls that affects only a small portion of a country's foreign transactions is unlikely to lead to a large change in net capital inflows´´

- Is the converse true? Doesn't that depend also on the degree of substitutability of the different available assets (as long as control does not affect *all* asset classes)?

- (Simplistic) household analogy

Comments: 4

- Drop the CCAs introduced in Argentina, Turkey and Russia during their crises in the 2000s
- Not sure I understand the rationale for this given your interest in the *average* efficacy of CCAs
- Same for Czech Republic, Hungary, Poland (structural and less related to Trilemma, but…)
- Do the results look different with these?

Comments: 5

- Cheap shot: You use the date when the CCAs became effective

- Since this is in the spirit of an event study, you should check in the business or financial press if these changes were anticipated and led to capital flows before the effective date that you are not picking up

- Probably will not matter much since your ``event window'' is effectively a quarter

Comment: 6

- Announcement and effective date different for 16% of your CCAs

- Are enough of those dates in different quarters so that you can get some identification of capital movements in expectation of capital controls?

Comments: 7

- Clarification 1: 110 unclassifiable CCAs in terms of inflows or outflows: do you include *each* of them on the inflow or outflow side, or all of them as a group? Former would seem correct. Clarify in footnote 15, page 17

- Clarification 2: To get your *net* measures do you add up the CCAs before or after weighting them with the portfolios? After would seem more intuitive to me. Clarify.

OTHER COMMENTS

Comments: 8

- ``Attempts to close the capital account would reflect a policy preference for fixing the exchange rate while retaining monetary policy autonomy´´

- Is the Trilemma the only show in town?

- There could be other motivations of CCAs such as prevention of housing or asset price bubbles

- Why not also look at these variables in the VAR?

Comments: 9

- Policy implication: `What you are doing is not going to help but it is going to help/hinder your neighbors." So the optimal outcome would seem to be when everyone puts in place controls, otherwise it has no effect

- Role of co-ordination?

Comments: 9

- But: Near VAR identifies multilateral effects using the assumption that ``domestic variables in the system do not have an impact on capital control decisions by policy-makers in other countries''

- Since CCA is a domestic variable, this means no policy coordination (OK, because it is Loch Ness monster...talked about but rarely seen)

Comments: 9

- This however suggests a Lucas-type critique: are these results a good guide to policy on co-ordination going forward?

Comments: 10

- By summing up the effects of the a CCA on different asset classes you are making an intuitive modeling choice but imposing linearity

- But: one of the things we have learnt about business cycles in EMEs is the regime shifting or stochastic trend aspect (Aguiar and Gopinath etc.)

Comments: 10

- Essentially, you are in a first order, log-linearized approximation of the business cycle model – what happens if those second order Taylor terms are large for EMEs (which they arguably are)?

- Imposed linearity may be masking volatility

- Easy to extend your methodology to include non-linearities and interaction effects

Comments: 11

- I find Walls versus Gates result puzzling: India and China have arguably been less affected by FED QE than, say, Brazil Indonesia and Turkey

Comments: 12

- Would be nice to see some discussion (in footnotes perhaps) of possible econometric issues with PVARs for non-econometricians like myself

Comments: 13

- Was a bit puzzled by the positioning of Section 5 of the paper

- Why not make it a subsection of Section 3?

Some advertisement

- Khatiwada (2015): effect of QE on EME capital flows