Discussion of "Regulating capital flows at both ends: Does it work?" by Ghosh, Qureshi and Sugawara

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Two papers in one?

- Empirical evidence that both source and recipient countries' capital controls bite on bank flows. Very interesting and useful.
- International cooperation (bilateral or multilateral?) in capital controls may be worthwhile: Keynes and White vindicated?
- Assuming capital controls are desirable, if their cost is convex, cooperation between source and destination countries may be optimal (cost sharing)
- Maybe inspired by the "reciprocity provision" in the CCB of Basel III
- (Note that the rationale is not based on externalities, which is the usual argument)

A useful and timely contribution

- Reconsideration of costs and benefits of financial integration (Coeure 2016: "financial globalisation 2.0"); capital controls are kosher again!
- Recent evidence that "it matters who your lender is", perhaps more than fundamentals (Cerutti, Claessens and Puy 2015)
- Review of the experience with the IMF "institutional view" and current G20 discussion
- Useful to distinguish between inflow and outflow measures (Schindler 2009)

The empirical model

- Gravity-type model

$$F_{ijt} = X_{it}\alpha + X_{jt}\beta + S_{it}\phi + R_{jt}\psi + \mu_{ij} + \lambda_t + \epsilon_{ijt} \tag{1}$$

- F is bank flows from source country i to recipient country j, X are controls for both countries, S (R) are the source (recipient) country's CARs
- Different CARs are included individually in separate equations (collinearity)
- Annual data 1995-2012, 31 source countries, 76 recipient countries
- Note: If I understand the model correctly it does not really capture an *interaction* between source and recipient country measures, i.e. there is no interaction term (though they run the regression separately for more or less open countries)

Data

- *Bank flows*: based on the BIS Locational Banking Statistics (i.e., lending between subsidiaries of the same bank in different countries is considered to be a bank flow)
- *Capital account restrictions (CARs)*: capital controls on outflows (inflows) for source (recipient) countries plus some prudential measures (restrictions to lending to non-residents, on accounts abroad and on open FX positions for source countries; restrictions on lending locally in FX, to purchase domestic securities in FX and open FX position limits for recipient countries)
- *Sources:* Capital account restrictions (CARs): IMF Annual Report on Exchange Arrangements and Exchange Restrictions and OECD Code of Liberalization of Capital Movements
- Binary data (more on this in the next slide)

Some comments on the CARs

- Consistency with other capital account openness measures
- Correlation with Chinn-Ito measure, for example? With measures that weigh the measures by their importance, as e.g. in Pasricha et al. (2016)?
- Are the values plausible? For example, they have non-zero CARs for European countries even in recent years, when these countries (according to the EU Treaty at least) should at least in theory be completely open

Endogeneity of CARs?

- The authors already recognise the potential problem and address it in several ways (lagging CARs; IV)
- If they want to pursue the IV approach further, institutional variables (e.g., EU membership) might be more promising instruments than the ones they use (central bank independence and democratic left wing government)
- Forbes, Fratzscher and Straub (2015) use propensity score matching to control for the endogeneity of capital flow measures (incidentally, how do the results compare with theirs?)

Obstacles to international cooperation in the area of capital controls

- Difficult to design capital control cooperation by country pair; any solution needs to be global
- Importantly, countries are subject to different institutional constraints (e.g., EU Treaty for EU countries, OECD Code for OECD countries, etc.)
- Shared diagnosis of the risks of financial integration is needed: unlikely, especially between advanced and emerging countries
- Cooperation between advanced and emerging countries likely difficult as interests likely diverge; more efficient GFSN may be a better alternative (Scheubel and Stracca 2016)

Other comments

- Adding lags (e.g. estimating local projections)? Are the effects of CARs persistent over time?
- Price vs. quantity measures?
- Variation over time: what happens when excluding the GFC?
- In the X vector I would add bilateral trade links and variables measuring bank structure and regulation (or more generally government effectiveness) in i and j (see also Beirne and Friedrich later in this session)
- How do you deal with financial centres?
- Placebo test?

Conclusions

- A useful and timely paper, with an impressive database and interesting empirical evidence
- I am however not convinced that it makes a strong case for (especially bilateral) international cooperation in the area of capital controls
- Still, it remains an interesting question to be addressed, and this paper is a useful element in that discussion