

Discussion of
“The Effect of Capital Controls on Portfolios
and Global Rebalancing,”
Forbes, Fratzscher, Kostka, Straub

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Discussion Overview

- Policy Context & One Question
- Two Econometric Points
- Key Contributions

Policy Context

- Problematic Inflows
 - Exchange rate appreciation & competitiveness
 - Financial fragility
- Assessment of capital control effectiveness depends on which problem is of concern.

Policy Context: This Paper

- Key Finding: Taxes on portfolio inflows reduce portfolio inflows.
- Contradicts earlier, more aggregate work.

A speculative question

Why do you suppose it is that you've found an effect for portfolio flows while many others haven't for capital flows as a whole?

Power? Or substitution? Or...?

- Is it... better focus in your tests (compared to a lack of power in more aggregated tests)?
- Or,... substitution from portfolio to fdi?
- The answer matters for our understanding the impact of capital controls:
 - substitution reduces relevance for exchange rate appreciation.
 - As it is, without an answer: clearest relevance for financial fragility concern.

First Econometric Point:

Caution on the multilateral interpretation

An Endogeneity Example: Suppose QE2 → Incipient flows to

Brazil

Other “Likely Capital Controllers”

Rest of World

Imposes Controls

↑P(controls)

Stimulated by QE2

We Observe:

Outflows from Brazil

Outflows from other “Likely Controllers”

Inflows to Rest of World

≠ Spillovers

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Second (Smaller) Econometric Point:

Tests of

$$H_0: \gamma_{\text{Brazil}} < 0$$

$$H_0: \gamma_{\text{Other}} > 0$$

are not independent tests.

Simplest case, assume:

1. The portfolio weights sum to one, so:

$$\Delta\omega_B = -\Delta\omega_{ROW}$$

2. Conditioning variables are constant.

Then: $\Delta\omega_B = \gamma_B \Delta\text{tax}$

$$\Delta\omega_{ROW} = -\gamma_B \Delta\text{tax}$$

So: $\gamma_{ROW} = -\gamma_B$

Contributions

- Insight: Fund managers' views & constraints
- Evidence: Tax on portfolio inflows reduces portfolio inflows
- Suggestive: Expectational Changes & Spillovers
 - Probability of additional controls*
 - Other Assets
 - Other Economies
- Efficacy: Compositional and Multilateral