Discussion of

"Capital Controls: Myth and Reality"

by Nicolas Magud, Carmen Reinhart and Kenneth Rogoff

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Overview of the Paper

- Central Question: How effective are capital controls to increase financial and macroeconomic stability?

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- Interesting and important paper
- Paper is currently under revision

Main Message

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- ...but empirical evidence does not appear to support theoretical predictions
- Why is there a disconnect?
- Two conjectures...
  1. Theoretical models miss problems of regulatory leakages
  2. Empirical analysis is limited by endogeneity problems

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- ...but theoretical models still predict powerful effects of capital controls with relatively large leakages in regulation (Bengui and Bianchi 2014)

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- Possible routes:
  - Use of high-frequency micro data for financial instruments could be helpful
  - Use structure of theoretical models to identify effects of capital controls

More on Endogeneity Issues

from Bengui & Bianchi (2014)

- Regression based on simulated data from Bianchi (2011):

$$CI_t = a^* X_t + b^* \tau_t + \varepsilon_t$$

where τ_t is the **optimal capital control**, CI_t are capital inflows and X is a vector of exog. and endog. state variables

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$$CI_t = a^* X_t + b^* \tau_t + \varepsilon_t$$

- Key result: $b > 0 \rightarrow$ a larger tax is associated with larger capital inflows!
- With higher "shadow sector" (and smaller sample) b becomes not significantly $\neq$ from zero
- Bottomline:
  - Empirical results not inconsistent with "effective" CFM
  - But model seem to suggest some degree of leakages

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- Empirical:
  - How do capital controls affect the probability of full-blown financial crisis?
  - Assess channels by which capital controls affect the macroeconomy (independendence of MP vs overborrowing)?

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- Empirical:
  - How do capital controls affect the probability of full-blown financial crisis?
  - Assess channels by which capital controls affect the macroeconomy (independendence of MP vs overborrowing)?
- Theoretical:
  - Why do capital controls have different effectiveness in affecting macro variables (e.g. FX, interest rates, CA)?
  - What are the positive and welfare implications of limited enforcement of capital controls?

Final Remarks

- I anticipate that paper will become highly prominent! I look forward to reading next version!
- Data availability from recent episodes should help to test the effectiveness of capital controls
- Need to understand the seemingly disconnect between theory and data
- For all of us: Lots of empirical and theoretical work to be done in the area