CAPITAL FLOWS

Discussion by Norman Loayza
The World Bank

2012 Annual Conference of the Central Bank of Brazil

1. “OPTIMAL CAPITAL TAX FLOWS IN LATIN AMERICA” BY JOAO BARROSO

Motivation

- Excessive borrowing (in good times) leads to crisis (in bad times)

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- Why excessive?
  - Externality:
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- Solution:
  - Tax capital inflow

What’s the optimal tax rate?

- Tax rate = Likelihood * Amplification * Severity
- 3 separate estimations

Technical comments

- Implementation requires questionable assumptions
- A chain of multiple regressions
- Each regression: ad hoc specification

Results

- International risk aversion
- High external debt
- Low international reserves
- Overvalued RER

Worse…

- Likelihood
- Amplitude
- Severity

Policy implication

- International risk aversion
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High Capital Inflow Tax

Questions

1. Why not deal directly with the fundamental causes?

Address the fundamentals…

- International risk aversion
- High external debt
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Questions

1. Why not deal directly with the fundamental causes?
2. A vicious circle could occur: capital inflow taxes may lead to lack of discipline

A vicious circle

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High Capital Inflow Tax

Questions

1. Why not deal directly with the fundamental causes?
2. A vicious circle could occur: capital inflow taxes may lead to lack of discipline
3. A dreadful game of speculation: private agents anticipate a change in tax rates

Interesting, good results…

But questionable policy implications

2. “TOOLS FOR MANAGING FINANCIAL-STABILITY RISKS FROM CAPITAL INFLOWS” BY MARCOS CHAMON ET AL.

The contribution

- Careful measurement of the effect of financial restrictions on “resilience” outcomes

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Restrictions:	Share of debt in foreign liabilities	Share of FX credit in total credit	Domestic credit growth	GDP growth recovery
General capital inflows				
Banking capital inflows				
FX debt flows				
General bank transactions				

The task

- Data intensive work
  - Separating inflow and outflow controls
  - Identifying by currency denomination
  - Separating domestic restrictions

Technical comments

- Low sample size for main cross sectional exercise
- Relative importance of other more standard macro responsible policies

The results

- Capital restrictions reduce international exposure

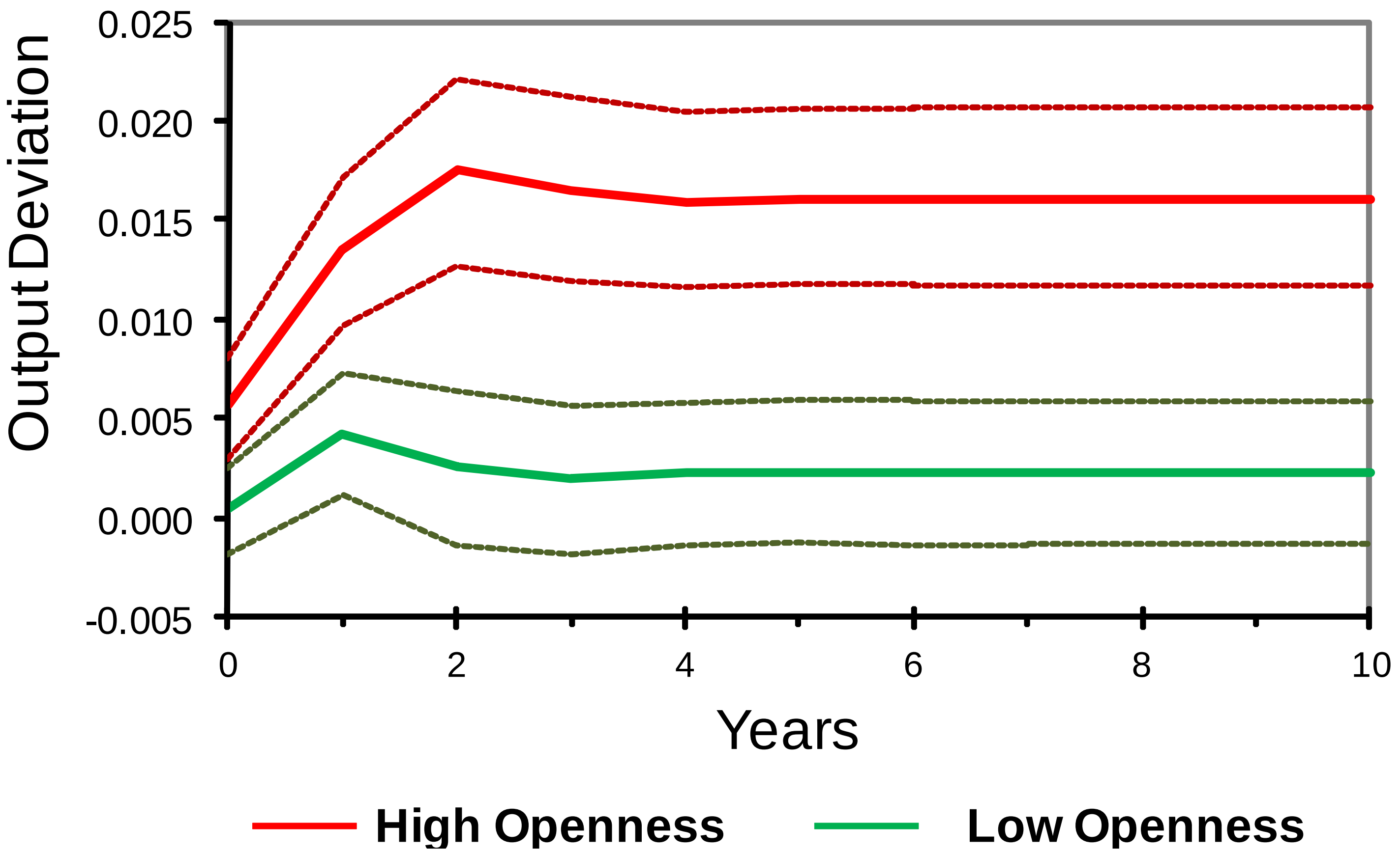
Restrictions:	Share of debt in foreign liabilities	Share of FX credit in total credit	Domestic credit growth	GDP growth recovery
General capital inflows	✓	✓		✓
Banking capital inflows				
FX debt flows		✓		
General bank transactions			✓	

Discussion of policy implications

1. What if this logic were to apply to, say, international trade?

External Vulnerability and Trade Openness (Loayza and Raddatz, 2007)

The effect of a terms of trade shock



Discussion of policy implications

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   a) Openness implies exposure and vulnerability
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   b) By analogy, should we impose larger tariffs, quotas, other “prudential micro” policies?

Discussion of policy implications

1. What if this logic is applied to international trade?
   a) Openness implies exposure and vulnerability
      1. Yes: in last crisis the trade channel was stronger
   b) By analogy, should we impose larger tariffs, quotas, other "prudential micro" policies?
   c) Retaliation: Beggar-thy-neighbor policies can lead to worse consequences

Yes, openness leads to more vulnerability **but…**

The vulnerability to external shocks is the cost of doing business in the modern world

The lessons from *victimization rates*

- What type of people have the largest probablity to suffer from crime?

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→ Working people: who are going back and forth from work

The lessons from *victimization rates*

- What type of people have the largest probablity to suffer a crime in a given period?

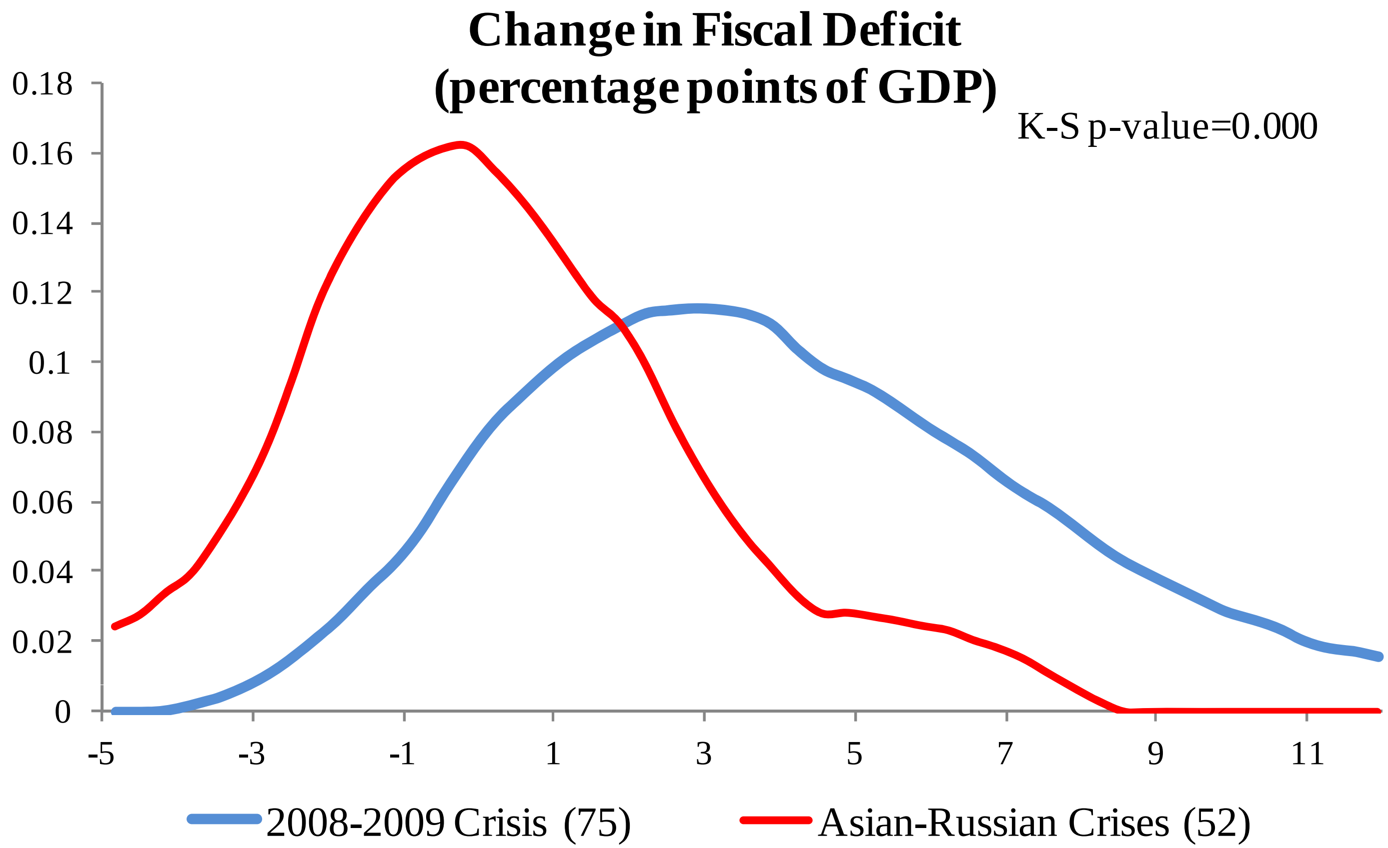
→ Working people: who are going back and forth from work

→ **So, is reducing work the correct risk mitigation strategy?**

Look for more robust, standard policies… they seem to work

Policy Responses: Fiscal Policy

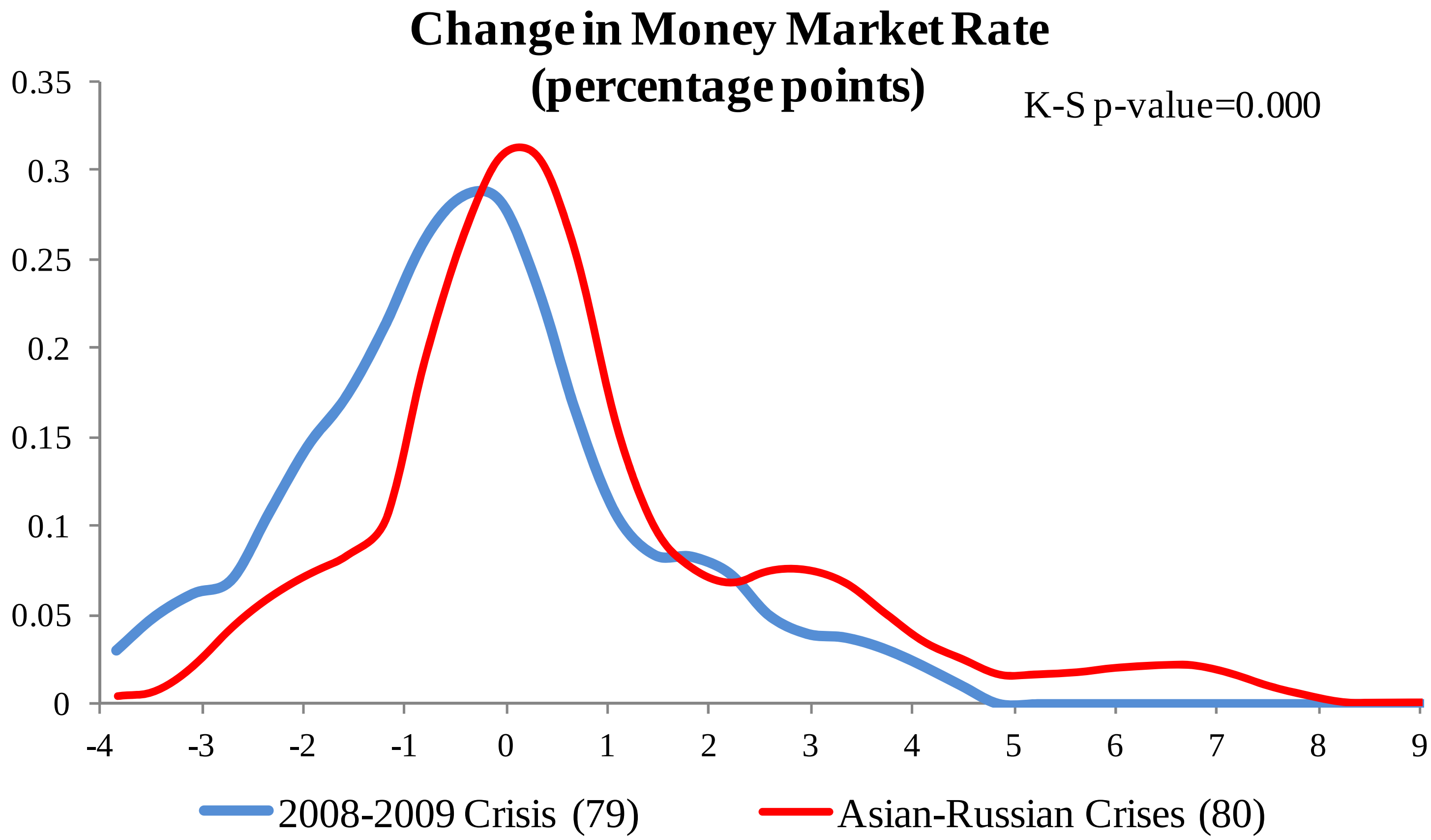
Now and Then – Emerging Economies



Didier, Hevia, and Schmukler (2012)

Policy Responses: Monetary Policy

Now and Then – Emerging Economies



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Before we tinker with too many margins…

- Try more neutral, standard macro policies: countercyclical fiscal policy, inflation targeting, ER flexibility

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