



BANK FOR INTERNATIONAL SETTLEMENTS

Discussion: Capital Controls Spillovers

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Disclaimer: The views expressed here are those of the presenter and not necessarily of the Bank for International Settlements



Overview

▶ Question

- ▶ How strong are the spillover effects of capital controls imposed by EMEs?
- ▶ Are there significant gains from coordination of capital controls *among EMEs*?

▶ Answer

- ▶ Spillovers can be sizable, but gains from coordination are limited

Model Setup

- ▶ Three country real business cycle model (no nominal rigidities)
 - ▶ One advanced economy and two EME (“groups”)



- ▶ **Key assumption in the model**

- ▶ Financial friction: Interest rate premium paid on foreign debt is increasing in level of debt
- ▶ (pigouvian) tax on capital controls counteracts this friction

$$\tau_t = -\phi \left(\frac{b_t}{GDP_t} - \bar{b} \right)$$

Main Results

- ▶ Moderate amount of capital controls is optimal
- ▶ Coordination gains are limited

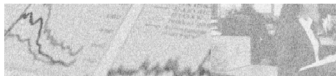
Normative Analysis

Risk-premium shocks		
Planner	Optimality	Consumption gain
EME1	$\phi = 0.04$	0.0365%
Nash	$\phi = 0.04, \phi^* = 0.04$	0.0442%
EME	$\phi = 0.05, \phi^* = 0.05$	0.0449%



First Comments

- ▶ Welcome addition to the theoretical literature on capital controls
- ▶ Papers typically look at capital controls in a small open economy, or a two country setting
 - ▶ three country setup like the one in this paper is more in line with the data

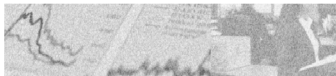


Comment: Assumption of EME being large

- ▶ Model assumes each EME is large enough to affect the advanced economy
- ▶ Interpretation in the paper: a group of countries simultaneously imposing the capital controls
 - ▶ but can this be justified based on first principles?
- ▶ Should the unit of analysis be an atomistic country in the EME1 group, instead of EME 1 as a large country?
- ▶ Alternatively, would a model with two small open economies be better suited to study this question?
 - ▶ Cook and Patel (2018)

Comment: Microfoundations for the key financial friction?

- ▶ Key feature in the model is the financial friction-debt elastic interest rate
- ▶ Modeled in a reduce form manner
- ▶ A more micro founded approach would provide additional insights.
- ▶ Alternatively, an estimation of the model to justify key parameters governing the elasticity of interest rate with respect to debt.



Comment: The investment channel of capital flows

- ▶ Unlike in this paper, capital inflows in EMEs are typically concentrated in the corporate (as opposed to household) sector
 - ▶ used to finance (unsustainable) investment booms.
 - ▶ investment goods also have a higher share of imports
- ▶ Would this make capital controls less effective?
 - ▶ With capital controls in EMEs, exchange rate appreciates by less, leading to more demand for exports to EME2



Comment: Several possible avenues to explore in follow-up work

- ▶ **Nominal rigidities**

- ▶ Do capital controls offer enhanced room for maneuver as far as monetary policy is concerned

- ▶ **Multiple sectors**

- ▶ Capital controls and dutch disease

- ▶ **Reserve accumulation by governments/central banks:**

- ▶ is there an equivalence with capital controls results in this paper?
- ▶ Literature has shown gains from coordination in FX reserves (Lee, 2018)

- ▶ Optimal policy in a more general sense?

- ▶ Short term vs long term debt

- ▶ Separate controls on inflows vs outflows

Summary and closing comments

- ▶ **Excellent paper addressing an important question in a novel setting**
 - ▶ Three country set-up provides a significant improvement
- ▶ The results are interesting, and whet appetite for subsequent exploration
 - ▶ Followup work exploring more dimensions of capital controls in a three country setting would be an important and timely offering to policymakers.

Thank you!



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