Comments on

Global Capital Flows and National Policy Choices

by Tytell and Wei

Andrew K. Rose

UC Berkeley, CEPR and NBER

A fine paper!

- Good topic
- Nice model
- Reasonable analysis
  - Key is focus on endogeneity of policies
  - Less Important: discreteness and Markov model
- Appropriate caveats

Issue: Link from Capital Flows to Purported Effects

- What's the tie between inflation and "good policy"?
- Shoe Leather Costs small even for moderate inflation
    - Median inflation <16% for median LDC (Table 2)
    - Standard Deviation irrelevant (cross-country!)
        - Perhaps really care about inflation volatility (correlated with level)?

Why Should Foreigner Investors Care About Inflation?

- "Original Sin" (documented by Frank Warnock and others) implies that most foreigners do not hold local-currency developing country debt anyway
- Local-currency risk relatively easy/cheap to hedge away (FX derivatives)

Are They Really Looking under the Light?

- *Capital taxes* (Rodrik) seem obvious place to look
  - Panel data may not be available
  - But welfare consequences probably higher
  - Also natural domestic benchmark

Another Alternative: Globalization reducing Corruption

- Many authors (Wei!) emphasize importance of corruption
- Could also do institutional reform, non-economic phenomena (human rights, etc.)

Yet one more alternative: use capital *flows*

- More responsive to domestic conditions than *stocks*

Should Developed and Developing Countries be Pooled?

- Effect of foreign flows on domestic policy likely to be MUCH higher in developing countries: why not use this?
- Inflation results should control for existence, depth of debt markets

Redo Estimation Interpretation

- System already over-identified without third equation
  - ER Flexibility and CB Governor as IVs for Inflation
  - Gov’t Changes and Coalitions as IVs for Budget
- Still, idea of using common component of capital flows intriguing

Other Data Issues/Quibbles

- Most striking feature of figures 1, 2 is countries with 0 financial globalization (data clustered to left)
- Many outliers … critical?
- Why not take logs of gross foreign assets? (like inflation!)
- Shouldn’t thresholds for Markov estimation be visually apparent?

Suggestion:

- Focus on interaction between “mood swings” and discipline
  - Does capital that’s “pushed” out of North matter less than capital that’s “pulled” into individual Southern countries?