Comments on “Bilateral Lucas Paradox”

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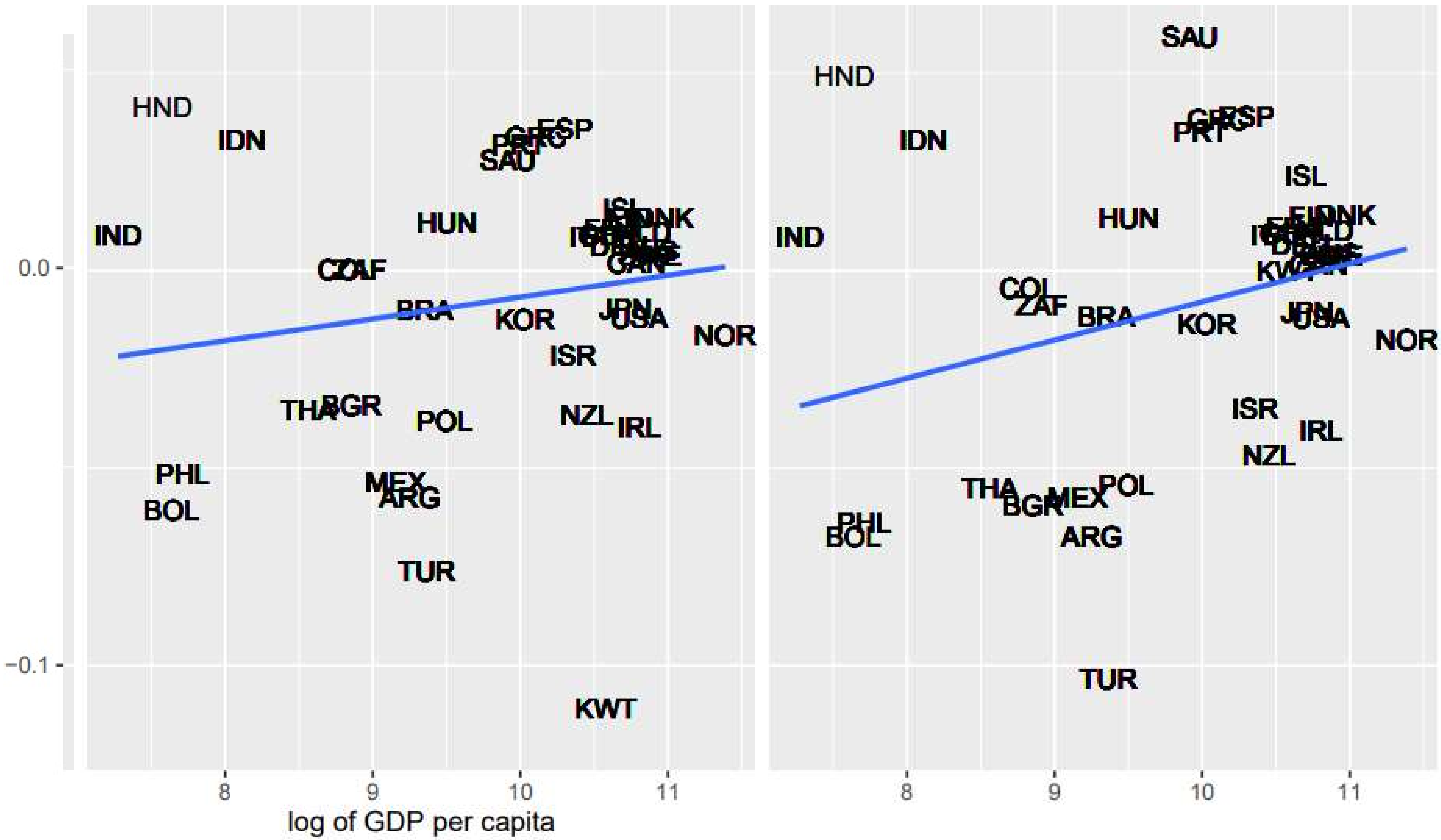
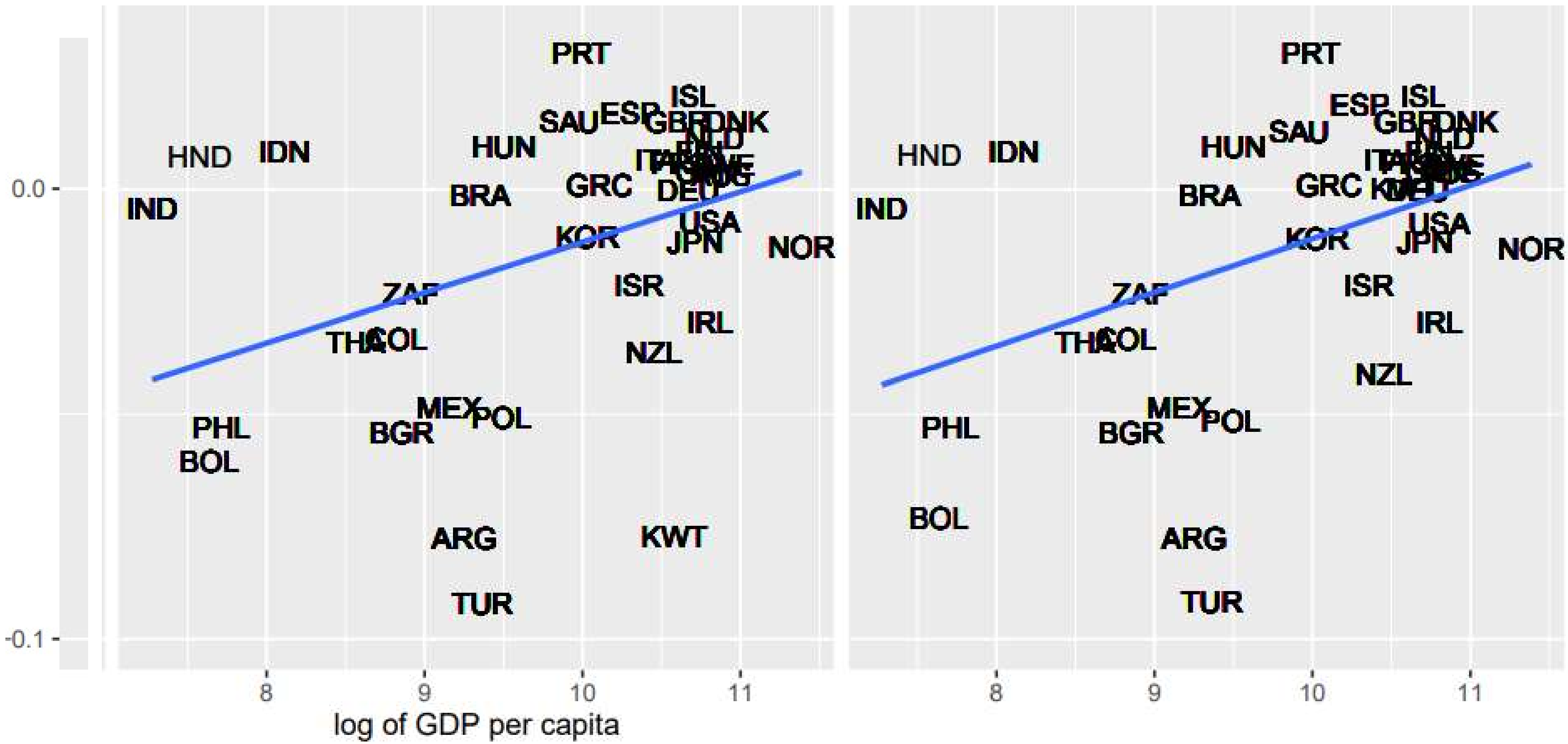
MPK on FDI relative to domestic investment (risk-unadjusted and adjusted, from Fig. 3)



MPK on international portfolio investment relative to domestic one (risk-unadjusted and adjusted, from Fig. 4)



Summary of this paper

- New stylized facts based on bilateral FDI and portfolio investment data

	The rich	The poor
External margin	Both in the rich and the poor	Generally only in the rich
Internal margin: the relative MPK on international investments to domestic ones	Around zero	Negative

- The fact on internal margin suggests that, unlike Lucas paradox, the question is why the poor invests abroad even if relative returns on international investment are low (negative)?
- To examine external and internal margins separately, this paper employs a 2-step sample selection model
- Based on the findings, the authors argue that institutions of investors matter for external margin

Comment (1)

- To adjust risk, this paper uses CCAPM with a parameter of relative risk aversion being 2
- But the literature on equity premium puzzle suggests much higher parameter values, such as 20 and more
- The authors may use a much larger coefficient
- More vivid results would be expected at least for FDI

Comment (2)

- This paper uses the CDIS and the CPIS for 2009-2018
- Coppola, Maggiori, Neiman, and Schreger (2021, QJE), “Redrawing the map of global capital flows: the role of cross-border financing and tax” construct a nationality-based bilateral portfolio investment dataset and find, for example, that
  - Nationality-based statistics and residency-based statistics, such as the CPIS, are vastly different
  - Security issuance of tax haven affiliates of BRICS issuers rapidly grew from 2007 to 2018
  - The CDIS also does not capture FDI through offshore issuance
- Although the authors check robustness to excluding financial centers from the sample, this resolves the issue only partially since the data still understate in particular flows from the rich to the poor
- Coppola et al’s (2021) bilateral data are available publicly

Comment (3)

- More controls may be needed
- For instance, since returns and productivity growth are closely related, Gourinchas and Jeanne’s (2013) allocation puzzle, in which capital flows more to developing countries with slower productivity growth, may be relevant to this paper; Because Gourinchas and Jeanne (2013) find that the pattern of capital flows is driven by national saving, regressions may control for it
- Since Ju and Wei (2011) convincingly claim that less financial developed countries invest in more financial developed countries, another potential controls are financial development indicators, which are easily obtained from a database of the World Bank
- If default risk of recipients and liquidity needs of investors may matter as suggested by the authors, why not try to control for relevant variables, such as CDS premia of recipients and liquidity indicators of investors?

Comment (4)

- The share of investment is defined as

$$Y_{i,j} = \frac{1}{T}\sum_{t=1}^{T} \frac{a_{i,j,t}/\sum_{i\neq j} a_{i,j,t}}{1/J_i}$$

- Here, J_i is the number of countries that country i invests, and $1/J_i$ is used as hypothetical random allocation
- Doesn’t size of recipients matter? How about GDP share?

Comment (5)

- This paper finds that many coefficients are statistically significant
- What about economic significance?
- How much can difference in institutions explain the difference in relative returns between the rich and the poor?
- How much do external and internal margins contribute to total capital flows?
    - Although this paper does not highlight effects of characteristics of investor and recipient countries for internal margin, there are some statistically significant coefficients

Comment (6)

- More explanations are needed for some results
  - Why does rule of law in recipients have negative impacts on participation in FDI?
  - Why does borrower protection of investors have negative impacts on participation in FDI and portfolio investment?
  - Why does political stability of investors and similarity of religion have negative impacts on participation in portfolio investment?
  - Why does financial openness of investors and recipients often have negative impacts?
  - Why does a higher tariff in investors have positive impacts on participation in portfolio investment?

Other comments

- To see the direct (main) effects of institutions, cross terms, instead of fixed effects, should be excluded
- Why not use a de fact segmentation measure, in addition to Chinn and Ito's (2006) de jure measure?
- Why coefficient of variation of exchange rates, not standard deviation of percent changes?