Comments on “Should governments encourage capital flows? Causal effects of capital flows on recipient economies” by End and Onoda

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Motivations

- It was well established that foreign capital inflows are significantly correlated with domestic economic development. However, the exact single-way short-run causal effects imposed by different forms of foreign investment to a range of economic growth outcome indicators in EME vs. non-EME have yet been clearly identified.
- This paper solves this problem by:
  - Utilizing a shift-share instrument to mitigate the two-way causality concern;
  - Controlling for indirect flows so that no common driver of both foreign investment and domestic development is omitted.

Highlights

- The paper documents that international capital flows can indeed cause economic growth in recipient countries several years after the inflow.
- Moreover, these effects become more prominent (1) for bond and other investment inflows in comparison to equity investment inflows such as FPI and FDI, (2) for promoting real GDP growth and domestic investment in comparison to consumption, consumption, interest rates, inflation rates, and unemployment rates, and (3) for EMEs in comparison to developed economies.

Major Concerns

1. Measurement errors can also case endogeneity
2. One may want to understand how unbiased we are by comparing the current result to that obtained from some baseline estimation setup of just leaving those potential problems unattended.
3. Reasons or mechanisms for bond being more helpful than equity, for real economic outcomes being more affected, and for EME seeing a larger effect than the developed world. Whether there exists an underlying consistent explanation?
4. It would be helpful if the authors can compare the magnitude of short-run and long-run estimated coefficients. How are short-run results related to long-run results, especially when the institutional quality comes into play in the long-run?

Major Concerns Cont’d

1. The contemporaneous effect lacks economic foundation, given that the benefits of those flows are assumed to materialize in a few years.
2. I am a little bit worried that some of the heterogeneity analytical results could be potentially related to how the instrument variables are constructed.
3. Different sources of data for constructing bond and equity position proxies are used. Are there statistical discrepancies?
4. What about the effect of deglobalization as evident by trade disputes and Brexit? What about the effect of uncertainties that may be measured by EPU or political risks?

Minor Points

1. It would be better if the estimation results and methods in past relevant studies can be summarized into one table.
2. The authors can discuss about the motivation of investment.
3. Subsection 4.4 is actually a combination of repeating exercises in the tail parts of the sample in various dimensions. However, why performing these exercises are not explained.
4. The question of "should governments encourage capital flows" might be too broad for this paper. I believe governments think more about the inherent characteristics of their domestic economies rather than the benefits of international capital flows. In addition, the cost of receiving foreign investment is missing.