

**Comments on Peter Henry's
“Capital Account Liberalization:
Theory, Evidence and Speculation”**

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Completely Reasonable Survey to Read

- Comprehensive (nothing missing)
- Balanced and Careful (no dramatics)
- Full of Caveats
- Lots of Auxiliary Probing, Explanations
- Extremely Honest!

Completely Impossible Paper to Discuss

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Can We Get More?

- Narrow Focus of Paper Seems Excessive

- Can We Step Outside Solow's Growth Model?

- Why do countries officially say they are liberalizing?

- Just access to capital flows and cost of capital?

- “... the relatively small financial effects of liberalization may simply indicate that the return to capital in developing countries is not that much higher than in the developed world.”
 - Makes one doubt value of using neoclassical model
 - (Similarly, the caveats associated with liberalization experiments lead back to the cross-sectional/panel approach)

An Alternative Model Altogether

- Bartolini and Drazen (*AER* 1997): Capital Account Liberalization is a Signal about government type
- Liberalizing *outflows* can generate *inflows*
- But liberalizing outflows should do little to affect cost of capital, investment or output (p16) within Solow model

Quibbles

○ Cross-Sectional Growth Regressions only

implicitly test for permanent effects

- During some part of transition after liberalization, growth should be high
- How does length of sample period compare to theoretical construct of transition period?
 - Rodrik: 10-year period – unreasonable?
 - Addressed in revision anyway

Excessively Broad Critique

- Many empirical papers link capital account openness to growth *with panel techniques*
 - Not all literature is purely cross-sectional
 - Ex: A) Edison, Levine, Ricci and Sløk (2002), with negative results; B) Razin and Rubinstein (2004), ditto
 - Still, focus on time-series variation welcome

Many Negative Studies of Liberalization on Growth

- Different Data Sets
- Differing Estimation Procedures
- Different Authors, Motivations
- Hence general skepticism towards positive results
(especially with publication bias)

But Then Again ...

- Think of Backlash against epidemiology; result of inconsistency with randomized clinical trial results
 - Ex: Women who take estrogen suffer significantly heart disease
 - But also fewer suicides, murders, accidents!
 - “Healthy User” selection bias

Provocative Conclusion

- “... liberalization of debt flows ... can cause problems. On the other hand, all the evidence we have indicates that countries derive substantial benefits from opening their equity markets to foreign investors.”
- Evidence against MM-analogue of liberalization?
 - Default costly, but no benefits from agency-reduction (or tax shields)

Suggestion 1:

Any Effect of Southern Liberalizations on North?

- OECD should experience outflows, rise in cost of capital, reduction in growth
- Would be interesting to try to tease out

Suggestion 2:

Use Matching Technique for Liberalizations?

- Difference in differences seems natural

Suggestion 3:

Link/Dismiss Short-Term Bank Loans and Trade Credit