

# Discussion of “Capital Controls and Income Inequality” by Liu, Spiegel and Zhang

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# Research question

- Implications of capital account policies for domestic income distribution
- Very interesting and new question
- Theory and empirics

# Theory: OLG model

- Two types of agents: entrepreneurs and households
- Labour income: identical wage
- Capital income
  - Entrepreneurs: return on investment  $R_l$
  - Households: return on deposit  $R$
- Income distribution determined by the difference between the two returns

# Source of income inequality

$$R = (1 - \tau_d)R^*$$

Outflow tax

$$(1 - \tau_l)R_{lt} = R_t^* \Phi \left( \frac{B_{ft}^l}{Y_t} \right)$$

Inflow tax

Risk premium

$$R_{lt} = R_t \left[ 1 + \Xi' \left( \frac{B_t}{Y_t} \right) \right]$$

Intermediation cost

Degree of capital account controls represented by those two tax rates

# Theoretical results

- Permanent capital account liberalisation improves income inequality
  - The gap between two saving returns becomes smaller
- Temporary surges in capital inflow increases inequality

# Empirics

- Panel of 87 emerging market economies, 2001-2018
- Measure of inequality = income Gini coefficient
- Effects of private capital inflows/outflows on the Gini coefficient

# Empirical results

- One SD deviation increase in capital inflow →  
1.35pp increase in Gini
- One SD deviation increase in capital outflow →  
1.56pp decrease in Gini

# Very nice paper

- Research question is very interesting and important
- Nice and clear theoretical results
- Rigorous empirical analyses



# Relationship between theory and empirics

- Theory part
  - Income inequality purely driven by the inequality of capital income (rates of return)
  - Both long run and short run analysis
- Empirical part
  - Gini coefficient
  - Short run analysis only (?)

# Gini coefficient

- Income Gini coefficient can be affected by many other factors than the rates of return on savings
- Capital account policies can affect
  - Wage distribution (skilled vs unskilled, tradable vs non-tradable)
  - Unemployment risks

# Does the empirical part examine effects of capital controls?

- The authors are very careful about identifying exogenous changes in capital flows
- Policy shocks or other structural shocks (such as risk shocks)?
- Narrative approach (eg. Romer and Romer)?

# Optimal policy

- Assumed policy function

$$\tau_{dt} = \begin{cases} \tau_{d0}, & \text{if } t = 0, \\ \tau_{d1}, & \text{if } t = 1, \\ \rho\tau_{d,t-1} + (1 - \rho)\tau_{d2}, & \text{if } t \geq 2. \end{cases}$$

- What about a policy rule in terms of goal variables (such as capital flows and income distribution)?
  - Maybe easier to interpret.
- Objective of analysing optimal policy not very clear
  - Comparison of actual policies with the optimal policy?