

DISCUSSION OF “INTERNATIONALIZING LIKE CHINA”

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OVERVIEW

❖ **IMPORTANT PAPER ON CHINA'S FINANCIAL REFORM**

- ❖ Opening up the capital account? When? How?

❖ **TIMELY**

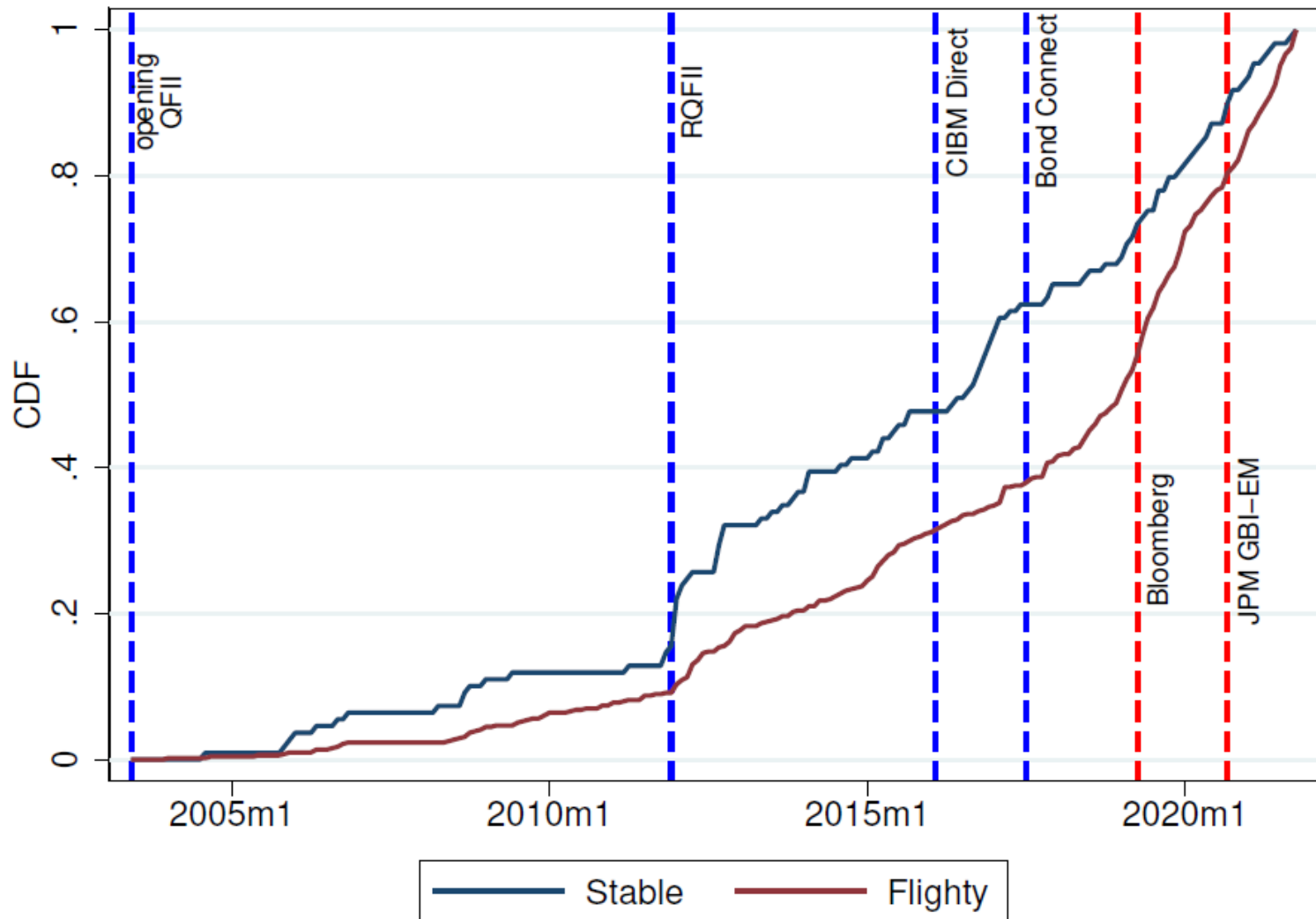
- ❖ The reflection of decade-long effort by China's reformists
- ❖ For outsiders, cross-road at this point
- ❖ (To me, the direction of controlled opening won't reverse, what is less clear if economic growth)

❖ **NICE EXECUTION OF MODELLING**

- ❖ Interesting and relevant mechanism
- ❖ Perfect from foreign investors side...from China's government side?

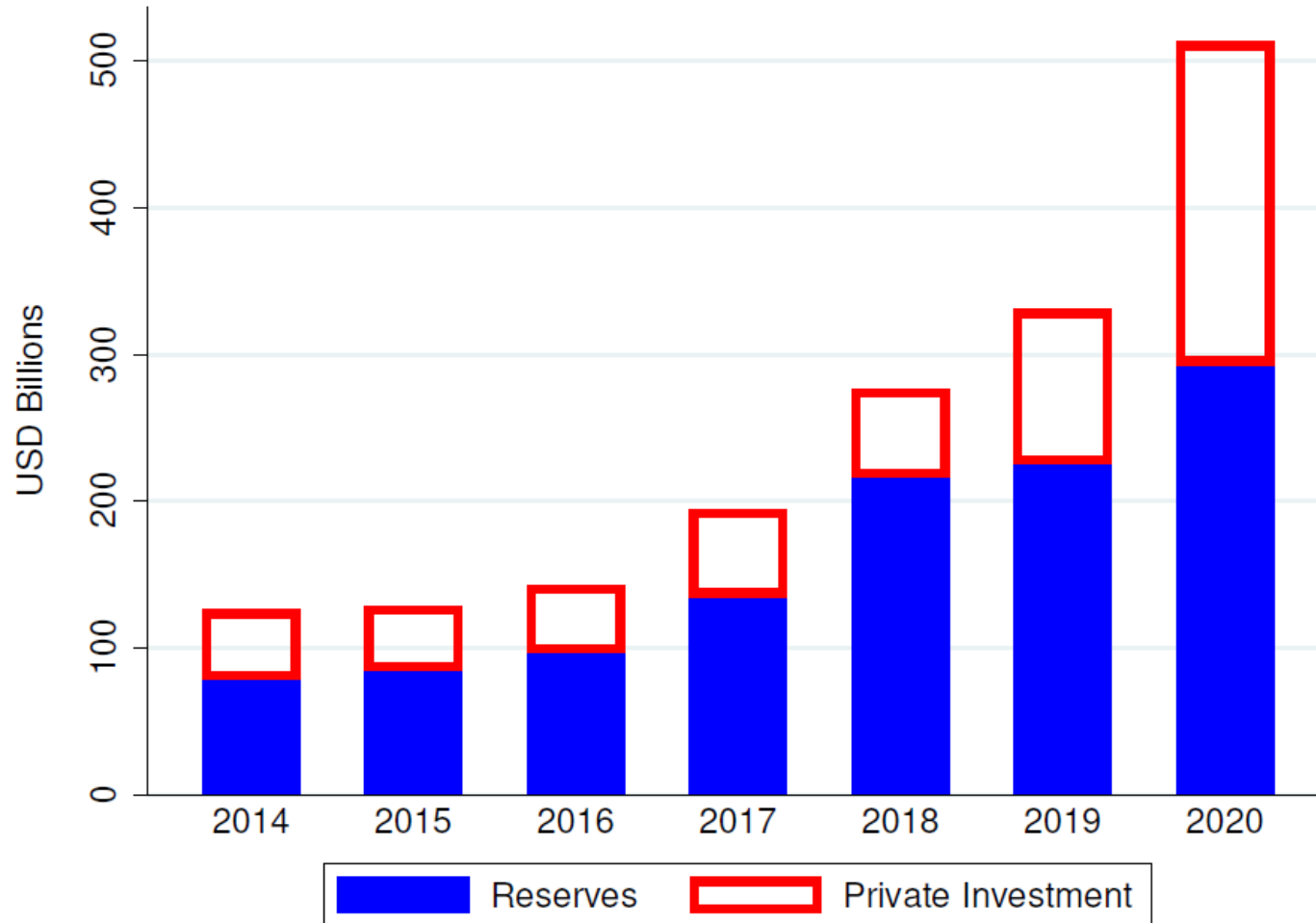
STAGED OPENING UP

Figure 3: Entry into Domestic Markets



SIZE OF STABLE VS FLIGHTY?

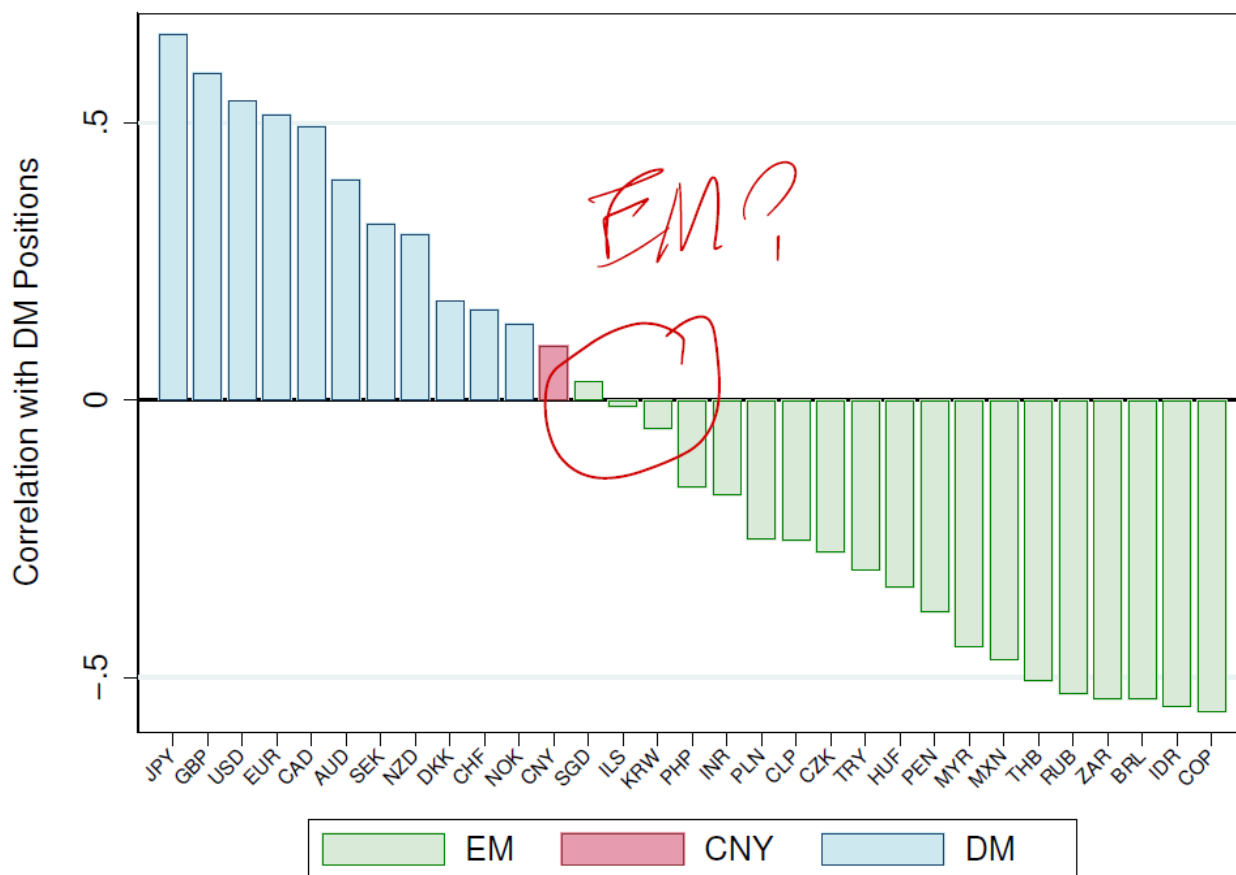
Figure 1: Composition of Foreign Ownership of Chinese-Issued RMB Bonds



ONE INTRIGUING FACT

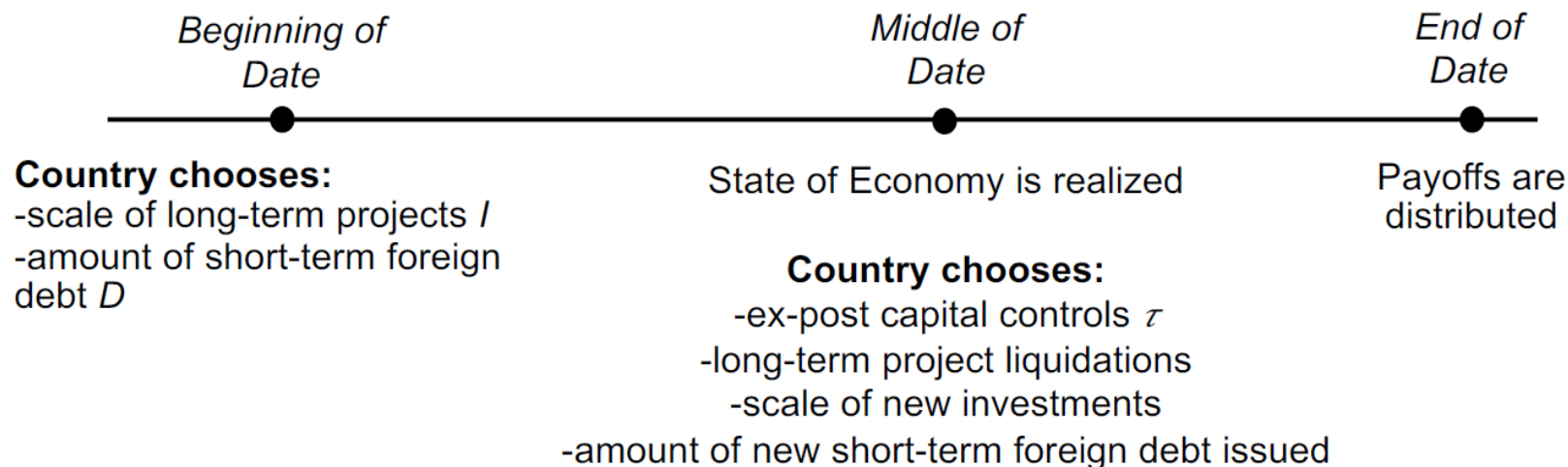
- Chinese bonds more like emerging market or developed market?
- Ex post return is unreliable; why not ex ante investor base?

Figure 4: Portfolio Similarity with Developed Countries' Local Currency Government Bonds



KEY MODEL INGREDIENTS

❖ STAGE GAME, I.I.D.



- ❖ Commitment type, never impose capital control
 - ❖ **Hard-core reformists???**
- ❖ Opportunistic type, short-term gain from imposing capital control

❖ PLACED IN AN INFINITE-HORIZON

REPUTATION MODEL Amador-Phelan (2021)

- ❖ Long-term reputation gain vs. Short-term pain (of letting capital outflow)
- ❖ Adding a twist of “first stable, then flighty”

CRISIS STATE

❖ IN CRISIS STATE

- ❖ The required haircut is larger once flighty investors are allowed in
 - ❖ It is as if investors are running
- ❖ The government can simply tax outflow

$$\left(1 - \underset{\text{capital control}}{\tau}\right) R^L D_t^L \leq \left(1 - \underset{\text{haircut}}{h_t}\right) \left(\underset{\text{original investment}}{QI_t} - \underset{\text{liquidation}}{L_t} \right)$$

- ❖ Utility flow to the government $V^L(\tau)$ is increasing in τ
- ❖ This hurts the debt investors, whose return is cut by τ

❖ TWO KEY INGREDIENTS

1. Imposing capital control ex post is tempting
2. The expected capital control negatively affects debt investors' demand

REPUTATION AND DEBT DEMAND

❖ **POSTERIOR π_t OF GOVERNMENT BEING OF A COMMITTED-TYPE**

❖ It is easier to work with the equilibrium probability of **No-Capital-Control** M_t

❖ **HERE,** $M_t = \pi_t + (1 - \pi_t)m_t$

❖ m_t : the endogenous prob. of opportunistic government **not to** impose capital control

❖ i.e., reputation

❖ **DEBT DEMAND:** $D(M_t, R)$ **WITH**

$D'(M_t) > 0$ **AND** $D'(R) > 0$

REPUTATION BUILDING (1)

❖ COMMITTED-TYPE STRATEGY

- ❖ Facing low reputation, committed type would like to start with stable investors with a lower haircut in crisis
 - ❖ Flighty investors are less valuable
 - ❖ The first stable dollar is always better than the flighty dollar
 - ❖ Quadratic adjustment cost, so at some point would like to have flighty investors

❖ INDIFFERENCE CONDITION

- ❖ Recall mixed strategy of opportunistic government
- ❖ For general $M_n \in \{M_1, M_2, \dots, M_{N-1}\}$, the opportunistic government needs to be indifferent between
 1. Imposing capital control (and hence revealed to be the opportunistic type)
 2. Gaining reputation and elevated to the next step (for better debt pricing in the future)
- ❖ At graduation N , excellent reputation, the temptation of reaping the reputation gain is too big (Kreps-Wilson, 1982)

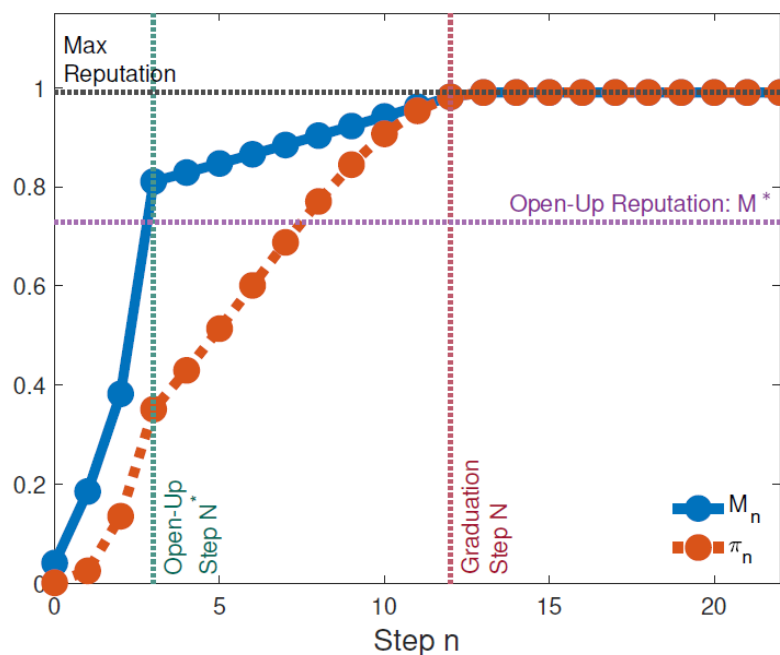
REPUTATION BUILDING (2)

❖ FIRST STABLE, AND THEN FLIGHTY

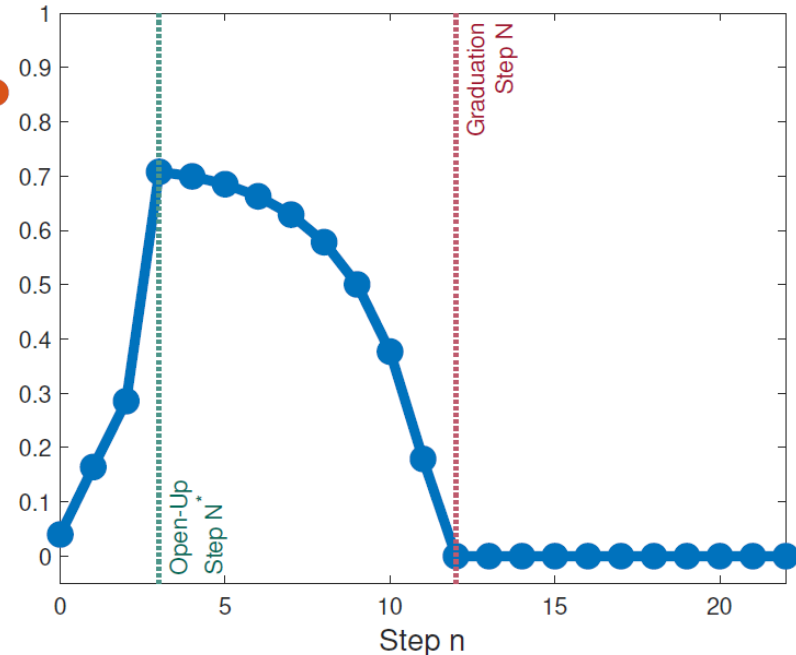
- ❖ Therefore, there exists N^* as the opening threshold to allow the entry of flighty investors
- ❖ Implied by the preference of committed type in any stage game
- ❖ Contribution relative to Compared to Amador-Phelan (2021)

❖ ONE INTERESTING IMPLICATION

- ❖ At switch, the reputation gain rises the most. Is this general?



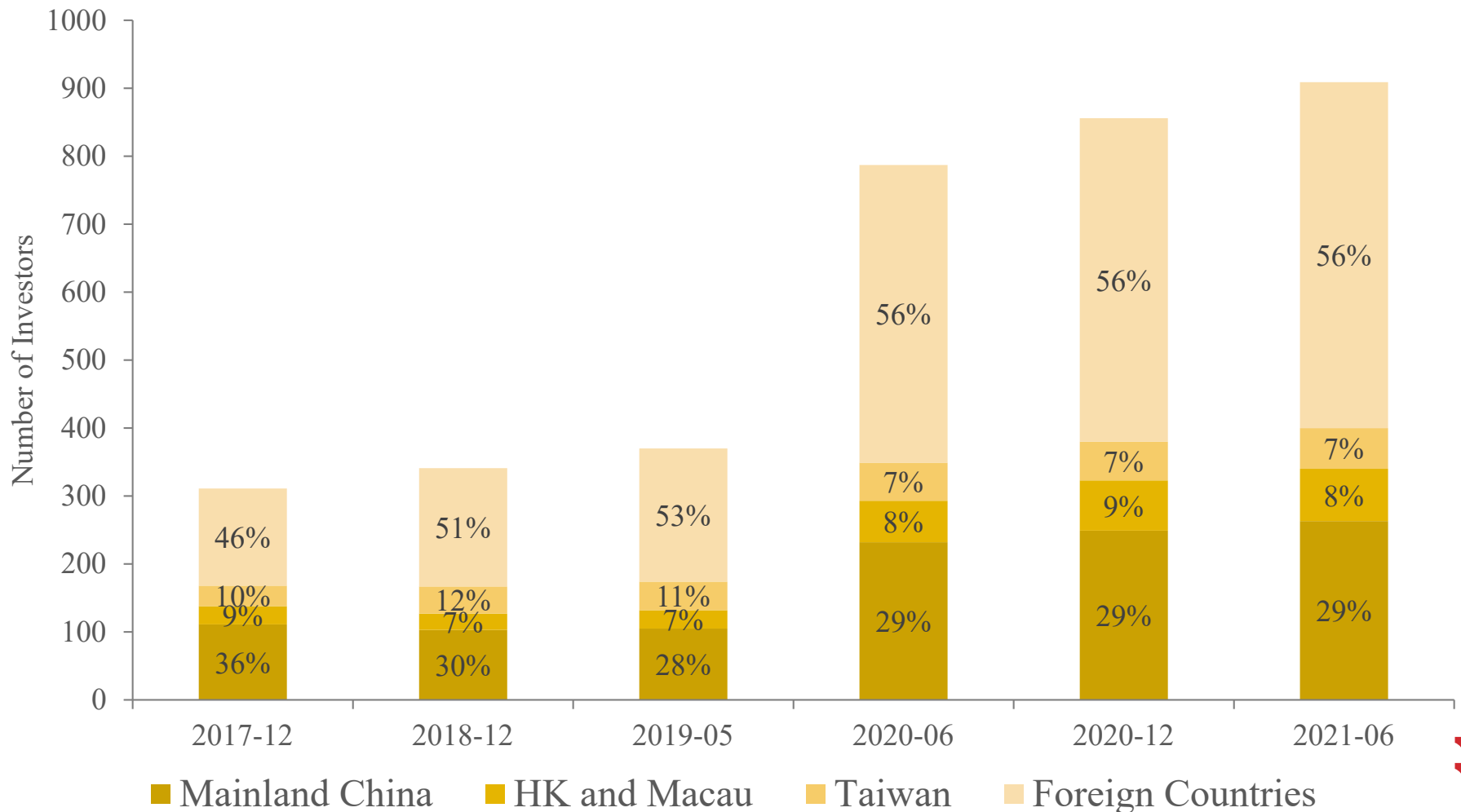
(a) Reputation M and Beliefs π



(b) Mimicking Probability m

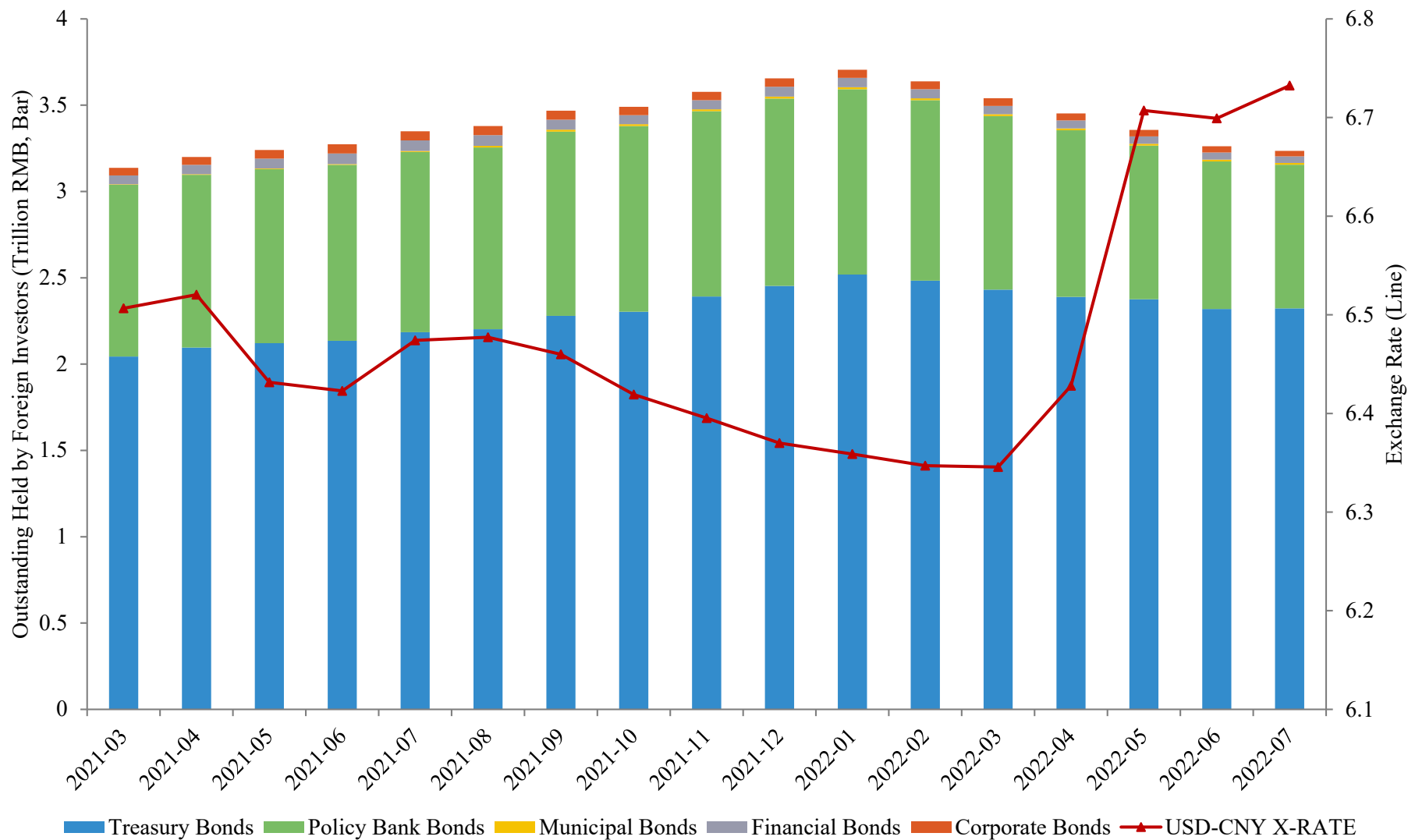
WHO ARE THESE FOREIGN INVESTORS?

Composition of "Foreign" Institutional Investors in Interbank Market



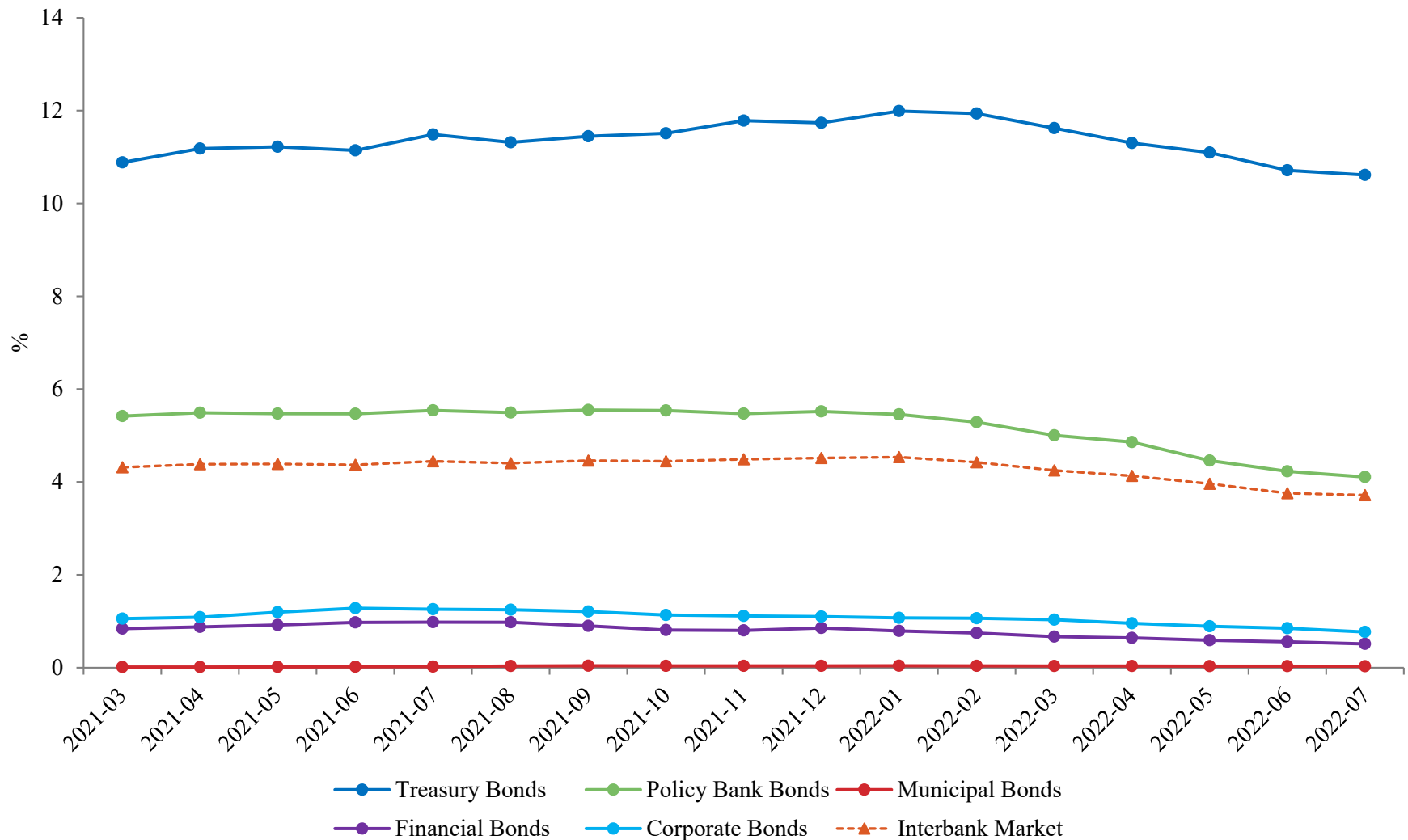
RECENT TREND (1)

Foreign Investor Holdings and Exchange Rate (RMB/USD)

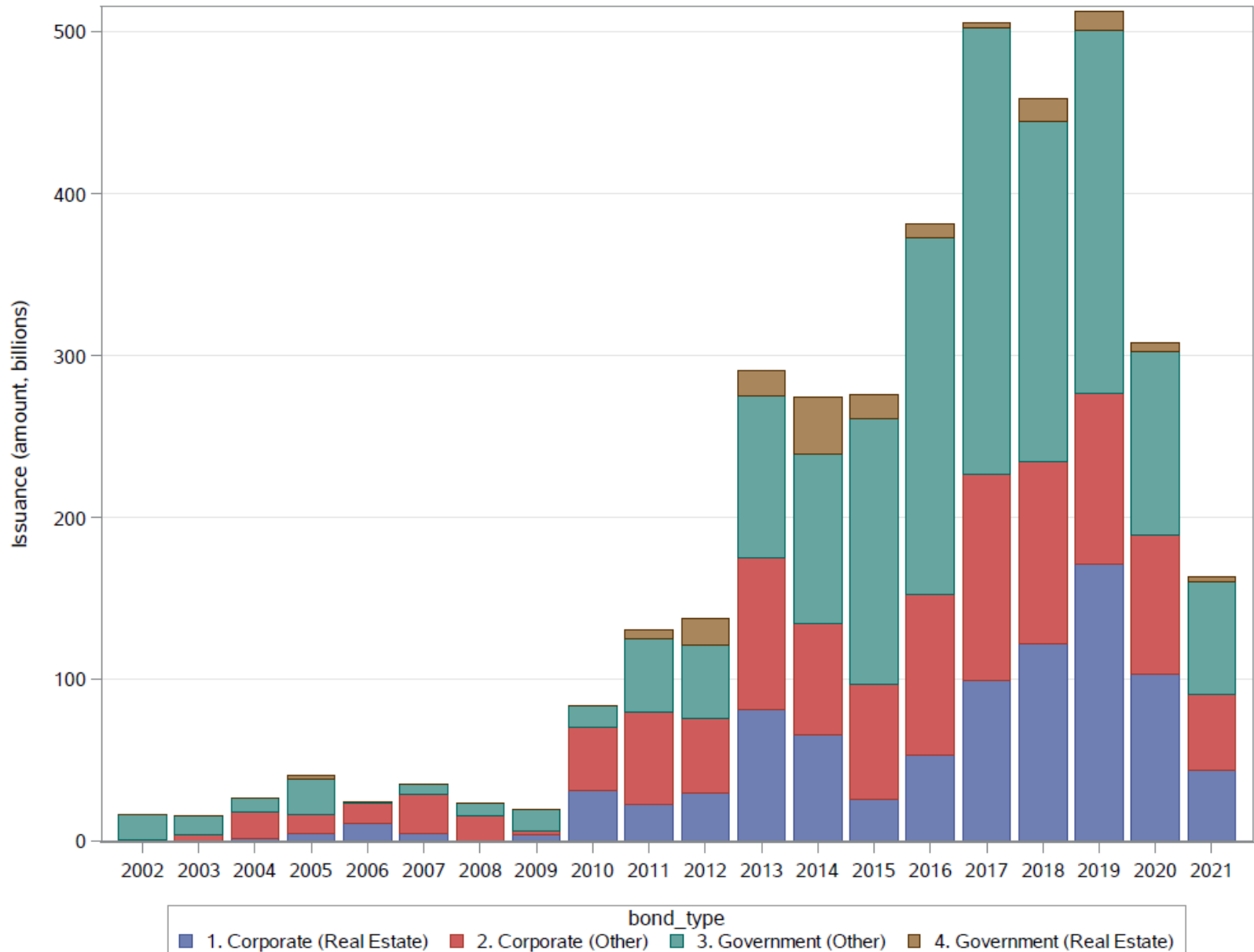


RECENT TREND (2)

Balance Share Owned by Foreign Investors



OFF-SHORE USD DENOMINATED BONDS



CONCLUDING REMARKS

❖ NICE PAPER

❖ IMPORTANT IMPLICATIONS FOR INTERNATIONALIZATION OF BIG EMERGING ECONOMIES

- ❖ BRIC countries

❖ A FIRST-ORDER FACTOR....BESIDES

- ❖ Reformists vs Conservatives

- ❖ Learning by doing or experimenting (learning from the other side)

❖ UNITED STATES TO ISSUE LOTS OF DEBT TO DETER CHINA?