Discussion of:
“On the Global Financial Market Integration “Swoosh” and the Trilemma”

by Bekaert and Mehl

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Summary

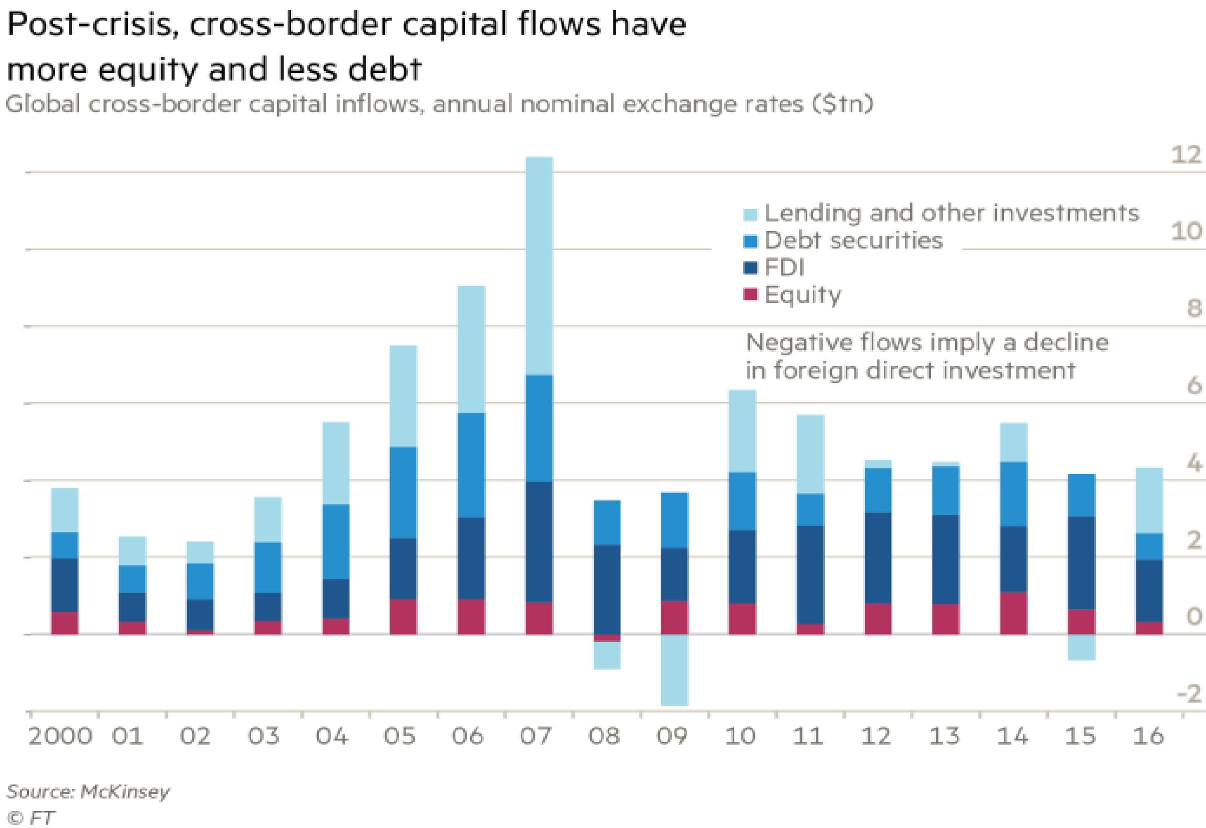
- Very interesting paper, makes important contribution. Very broad in scope
- 2 main sections:
  - Create a new index of global financial integration
  - Contribute to 3 debates:
    - Shape of historical global financial integration (V, U, J, swoosh)
    - Has there been a reversal of financial globalization
    - The Trilemma

The new measure

- Uses a factor model with global and regional equity returns and a set of “instruments”
  - Not classic IV instruments, but controls & interactions

- Fundamental question is how broadly this applies:
  - 17 countries (all ADV), all but 4 in Europe
    - May require that we are careful in how broadly we interpret the measure
    - Makes me wonder a lot about how to think about the regional results (2 regions have just 2 countries)
  - Equity not other flows
    - Authors argue that different controls are correlated & they are. Also, research suggests you need to REALLY close the Fin account which means that measuring any one market may be informative.
    - Equity flows bigger in previous periods than we might guess
  - What does integration mean: is it financial flows or is it the fact that shocks spread and there’s a capacity for flows

Concern in pictures



- The equity flows are small
- The size of the other flows move around massively in ways not connected to the equity flows
- Still broadly think their points hold, just something to keep in mind

A few other issues

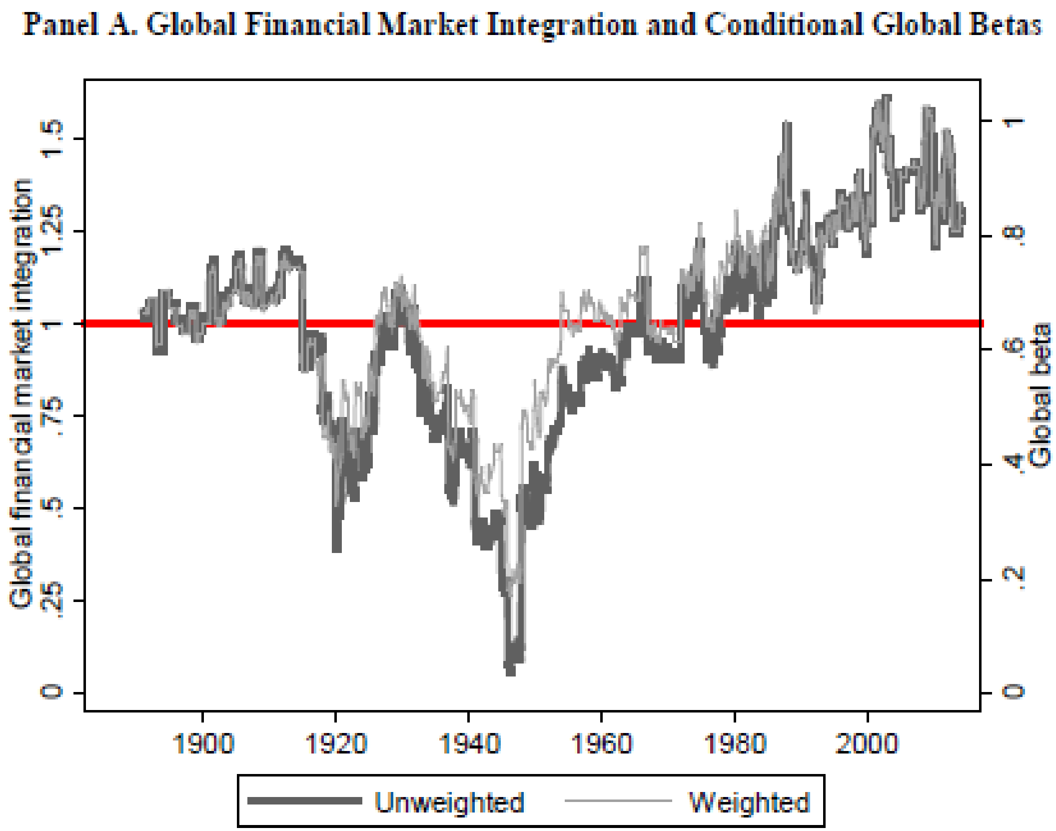
- Dollar returns
  - Will this lower the correlation for floating episodes
  - Isn’t dollar volatility now infecting the returns.

- U.S. in sample
  - Is it correlated with the world, or is the world correlated with it.

- Overall, though, for this set of countries, I believe the results. Well done and well explained

- But for some, is it true: for example China
  - Have clearly tightened in last 18 months
  - That has slowed outflows & given them more monetary autonomy
  - But equity correlations have gone up
  - On average, equity market relationships may correlate with financial integration, but will it work generally?

Global Financial History in a Snapshot



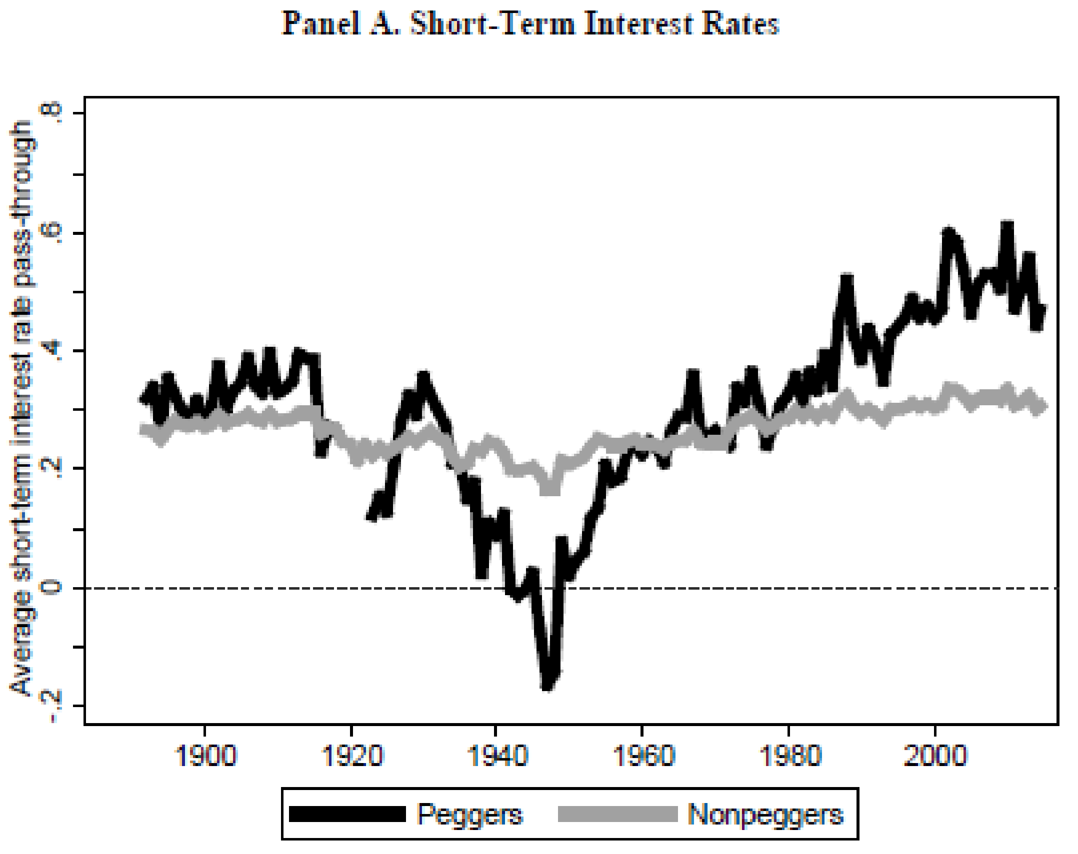
- Argue it is a swoosh and not collapse post 2007-9 crisis.
- Results: authors note they can't really push too far a specific shape
  - Also, this is the integration for these 17 countries.
- Really interesting that 73-90 is still relatively low

The Trilemma / Dilemma debate: two frames

- ***Fear of floating***:
  - "On the other hand it is possible that capital markets are so tightly integrated that nonpegged countries also lack monetary freedom. …… **In this case, there is an open economy dilemma, not trilemma:** the choice is to have monetary freedom or open capital markets. ….there would be no difference between pegged and nonpegged countries." Shambaugh 2004
  - Calvo and reinhart(1999). Frankel, Schmukler, Serven (2004).

- ***The global financial factor:***
  - "Whenever capital is freely mobile, the global financial cycle constrains national monetary policies regardless of the exchange rate regime" "**The global financial cycle transforms the trilemma into a "dilemma**"
  - Rey (2013), see also Passari and Rey (2015)

Trilemma results



- Being Pegged changes the correlation
  - and matters more if open,
  - and matters for LT rates too
- Their results actually more supportive of trilemma: Peg only matters when open
  - Floats largely unaffected by fin openness

Comments

- Really small & unrepresentative sample of countries
- Peg definition pretty broad
  – Floats and nonfloats vs pegs & nonpegs
  – E.g. Canada would be pegged in the entire post WWII sample
- What’s going on with euro
  – Can’t figure out where all the nonpegs come from post 1990
- Given sample, becomes largely a cross-era exploration
  – Nearly all pegged & open in GS
  – Nearly all pegged & closed in BW
  – Nearly all open in post-BW
- Most of the differences from OST likely sample
  – GS nonpegs
  – Much more 1914-59, which gives a lot more closed pegs

Results in the literature

TABLE 2—2 × 2 CLASSIFICATION OF EXCHANGE RATE AND CAPITAL CONTROL REGIMES (OLS)

	Peg		Non-peg		
	Coef. (s.e.)	N $[R^2]$	Coef. (s.e.)	N $[R^2]$	Open versus non-open
Open	**0.68*** **	**433**	**0.23** **	**581**	0.27***
	(0.08)	**[0.28]**	**(0.10)**	**[0.02]**	(0.07)
Non-open	**0.40*** **	**967**	**0.09***	**1,145**	
	(0.06)	**[0.14]**	**(0.05)**	**[0.00]**	
Peg versus non-peg	0.33***				
	(0.06)				

Klein and Shambaugh (2015)

- Note that nonpegs not zero (as in this paper), quite familiar result
- Both open and peg matter. Peg here defined more narrowly
- In many ways, question is your priors

More granular split

Table 3—3 × 3 Classification of Exchange Rate and Capital Control Regimes (OLS)

	Peg		Soft peg		Float			
	Coef. (s.e.)	**N [R^2]**	**Coef. (s.e.)**	**N [R^2]**	**Coef. (s.e.)**	**N [R^2]**	Versus mid-open	Versus closed
Open	**0.68***	**433**	**0.32**	**301**	**0.17**	**280**	0.06	0.29***
	(0.08)	**[0.28]**	**(0.13)**	**[0.04]**	**(0.14)**	**[0.01]**	(0.08)	(0.09)
Mid-open	**0.54***	**438**	**0.38***	**273**	**0.07**	**250**		
	(0.06)	**[0.22]**	**(0.08)**	**[0.05]**	**(0.08)**	**[0.00]**		
Closed	**0.25***	**529**	**0.18***	**230**	**−0.06**	**392**	0.22***	
	(0.07)	**[0.07]**	**(0.10)**	**[0.01]**	**(0.11)**	**[0.00]**	(0.06)	
Versus soft peg	0.19***				0.22***			
	(0.07)				(0.08)			
Versus float	0.41***							
	(0.07)							

Klein and Shambaugh (2015)

- Split out the soft pegs & floats look even more independent
- Mid-closed doesn't really help – supports the overall methodology of this paper. You have to really close for the controls to work, so if you are open enough for equity correlation, you'll be financially open.

Summary

- Great paper
- New index really interesting
- Results on history of global integration convincing (for the subset studied)
- Results for trilemma nice addition to debate (again, for the subset studied)
- Would love to see the follow up papers where they dive into these topics in more detail with more countries if possible. Or different samples where needed so they can speak more authoritatively on some of these topics