Comments on Fine-Tuning an Open Capital Account in a Developing Country: The Indonesian Experience Sisira Jayasuriya and Shawn Chen-Yu Leu

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The paper basically has two components: (1) a descriptive portion which presents the history of capital account liberalization and the use of capital controls in Indonesia, and (2) the construction of an index of capital controls and subsequent use in a structural VAR model for assessing the effectiveness of controls.

The first portion is very useful as it presents an account of Indonesia's relatively open capital account before the 1997 Asian financial crisis, its continued compliance with IMF recommendations of keeping the capital account open during and in the aftermath of the 1997 crisis, and its use of capital controls beginning in 2004.

The second portion of the paper discusses the construction of a capital controls index using the IMF's *Annual Report on Exchange Arrangement and Exchange Restriction* (AREAER), unlike the other papers in the seminar which used respective central bank data. Although this is justified on the grounds that it is difficult to gather historical data and information from local resources, it must also be pointed out the AREAER database also has some gaps which is filled through consultations with the concerned countries. Furthermore, the methodology of index construction must be explained some more, especially the weights accorded to specific de jure capital controls.[1]

In response to this paper and the other papers which were presented, note that in most papers a typical finding is that capital controls only have temporary effects on volumes but would have permanent effects on the composition of the flow. While there are minor differences in findings, there seems to be an emerging pattern that effects on capital flows are temporary. With respect to attempts at assessing the effectiveness of recently imposed controls, it might be too early to see the effects.[2]

With respect to data treatment, the modeling was done on level variables without the requisite regularity tests, especially for stationarity and cointegration.[3] As regards the use of structural VARs in the assessment of

[1]This was subsequently done in the revised version of the paper

[2]Capital flows surged in 2010 after the 2008–2009 global financial crisis.

[3]The regularity tests are discussed in the revised version of the paper.

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effectiveness of capital controls, the methodology has its merits, but it could also have disadvantages. For one, it is often difficult to find significant results when employing VARs in this type of analysis since capital restrictions tend to occur in discrete jumps. Structural VARs are also sensitive to the ordering of endogenous variables such that it would probably be useful to augment the study with another methodology like event analysis to ensure robustness of results.

Lastly, capital controls are already in the toolkit, but it should be noted that the use of capital controls could also have unintended effects, and the impact depends on the instrument that is used and the entity that is being targeted. There is a need for more resolution on the framework and approaches.