Discussion

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Elusive Safety: The New Geography of Capital Flows and Risk

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Disclaimer: this is a hot topic …

… and the views in this discussion are mine and do not necessarily represent the views of the International Monetary Fund!

Summary of the paper

- Increasing assets and liabilities in THFC
  - Less tax -> profit shifting
  - Less regulation
- THFC investors hold riskier debt issued in the US
- THFC investors often hold intangible-intensive firms in the US
- THFC investors require a higher sharp ratio – “search for yield”
- Model
  - Endogenous profit shifting and monitoring
  - More liquidity → cost of funding ⬇ → firm profits ⬆ → entry of riskier firms; less monitoring

Setting of the data

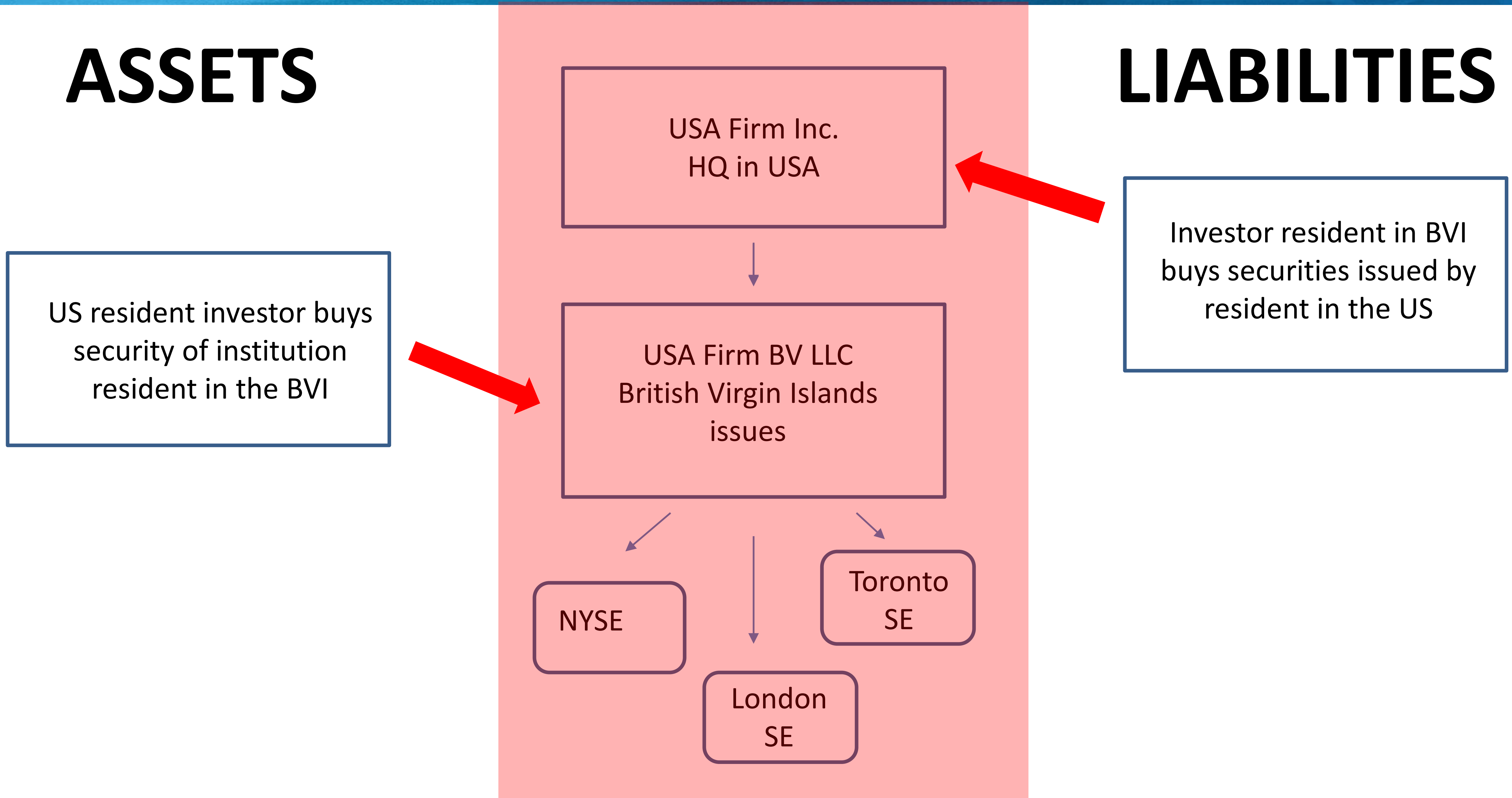
ASSETS

US resident investor buys security of institution resident in the BVI

LIABILITIES

Investor resident in BVI buys securities issued by resident in the US

What is happening



Regulation as driver of THFC intermediation

As argued in the paper because

- offshore activities increased around 2010, namely the year of the Dodd Frank Act, and
- are largely intermediated by "unregulated" mutual funds.

Thoughts:

- Could be tested in empirical setting – more heavily regulated sector = more intermediation through THFC?
- It might all come down to tax …
  - In order to avoid Dodd Frank, US Firm Inc. could also go to Toronto SE directly, would not need intermediation through BVI
- If we look at data since 2007, the pick up in 2010 might just be a recovery

THFC invest in US intangibles-intensive firms

As argued in the paper because

- incentive is bigger for firms that can easily move their activities
- whereas firms with local capital can get loans from banks
- while banking regulation in the US does not allow intangible as collateral

Thoughts:

- Very nice empirical finding and very novel
- The mechanism is not yet entirely clear because
  - It is unclear whether anything has to be moved for selling securities to THFC
  - It is unclear whether firms substitute bank loans for debt/equity issuance easily
  - Not clear how the correlation of risk and intangibility contributes to the mechanism
- Could be added to the model

Some other suggestions

1.) More empirical evidence

- Use the security level
  - So far, the security level is only used to aggregate the sharp-ratios
  - One could use it to control for security characteristics or even control for security/firm FE
- More analysis on the asset side

2.) Some final thoughts on the model

- Could be more connected to the empirical analysis:
  - Model is trying to address the issue of profit - potentially incorporate this in the empirical motivation
  - Nice(st) empirical finding (intangible firms held by THFC investors) is not in the model
    - Is more intangibility a higher chi?
    - How should we think about the interaction of risk and intangibility in Figure 11 (very linear!)?
  - Assumption of endogenous monitoring potentially more plausible for bank loans

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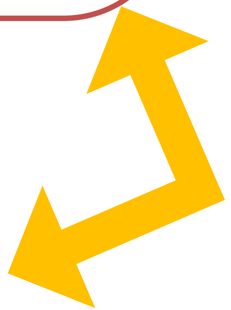

- Model
  - Endogenous profit shifting and monitoring
  - More liquidity → cost of funding ⬇ → firm profits ⬆ ↗ entry of riskier firms ↘ less monitoring