Discussion of Araujo and Leão
OTC Derivatives: Impacts of Regulatory Changes in the Non-Financial Sector

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OTC Derivatives: Impacts of Regulatory Changes in the Non-Financial Sector

- ***Why this paper is important***
- ***What this paper does***
- ***What this paper does well***
- ***What this paper could do even better***

Why this paper is important…

- ***New literature on macroprudential use of international capital controls***
- ***Welfare gains in terms of preventing asset price bubbles are clear***
- ***Is there a downside for the real sector?***

What this paper does…Introduction

- ***Natural experiment***
- ***On September 16th 2011, Brazil imposed a tax on FX derivatives short positions only***
- ***Authors have access to database of all non-deliverable foreign exchange forward contracts***

What this paper does…Theory

- ***Assume non-financial firms long USDBRL forward positions are offset by short taxable positions by banks***

- ***Cost of bank's position measured on transparent, liquid USDBRL futures market***

  - ***Compare futures and forward prices before and after tax***

What this paper does…Testable Propositions

- ***For long NDF positions (=short bank futures market positions), forward-futures spread should widen because of tax***
- ***For short NDF positions (=long bank futures market positions), forward-futures spread should be unaffected by tax***

What this paper does… Results

Controlling for bank and form characterics along with variables that affect the FX market:

- ***For long NDF positions the spread rises by 52%***
- ***For short NDF positions there is no significant effect***

What this paper does well

- ***Very convincing experiment***
- ***Unique data set***
- ***Very clear result***
- ***Importing firm faces a penalty when it needs to hedge a future payment in dollars i.e needs a long USDBRL position.***

What this paper could no better…econometric techniques

- ***Difference-in-differences***

- ***Endogeneity of control variables***

What this paper could no better…equation specification

- ***Control variables e.g. Spot FX rate, FX volatility, FX asymmetry need to be motivated in more detail***
- ***Instead of fixed effects for banks and firms, it might be better to use measures of firm or bank size***
- ***Though the results are always significant, estimates depend on exact specification of control variables***

Conclusion

- ***Very important contribution***
- ***Law of unintended consequences***
- ***Capital controls at the very least cause gross welfare losses***