

RESPONSES TO REFEREE REPORT 2

First of all I would like to thank the referee for his suggestions. The comments are very thoughtful and raise some issues not previously considered.

- 1) **COMMENT:** *“The contribution of this paper to literature is that the author allows the adjustment costs of capital differ in ownership of firms. The small adjustment costs that multinational firms face can explain the fact that multinational firms have a high propensity to adjust their capital stocks relative to domestic firms in Belgium. Therefore, raising the profitability of multinational firms encourage them to increase capital investments in the local markets. This suggests that government can use tax credits or improve infrastructure to attract foreign investments in order to rapidly accumulate domestic capital stocks.*

In this respect, the main strength of this paper is to quantify the heterogeneity in costs of capital investments across different firm types (here is ownership status). Recent trade literature has found that the fixed costs of firm export participation vary across firm size. This paper seems to be the first one to investigate whether capital adjustment costs vary across firm ownership.”

RESPONSE: I thank the referee for his clarifying comments.

- 2) **COMMENT:** *“On the weakness side the paper did not provide a clear explanation why multinational firms in Belgium have a high likelihood to have negative investments than domestic firms. Facing the lower capital adjustment costs, multinational firms can easily either increase or reduce their capital stocks comparing to domestic firms. However, it seems that multinational firms in Belgium are likely to choose the latter case (disinvestment). One possible explanation is that multinational firms in Belgium face a high possibility to suffer negative profitability shocks. Table 3 indicates the mean (and median) values of the idiosyncratic profitability shocks are lower for multinational firms relative to domestic firms, suggesting that the profitability of multinational firms are likely to be lower than domestic firms. The low profitability may prevent multinational firms from expanding their size in Belgium.”*

RESPONSE: Considering referee's comment on the relative high likelihood of MNFs' negative investments (a comment linked also to minor comment 2) I would like to note that the 50.6% fraction of negative observations is not far away from the 45.4% fraction of domestic firms' negative investment observations and I think that this small difference can indeed be explained by the relative low profitability of multinational firms as it is indicated in Table 3 when comparing the mean values of the idiosyncratic profitability shocks for the two firm-types. I am grateful to the referee for pointing out this explanation.

MINOR COMMENTS

- 1) **COMMENT:** *“The author mentioned that investors want to reduce the risk of investments by diversifying their portfolios in different countries (p.3 and p.21). However, it is not clear why international diversification among investors can explain the low capital adjustment costs. The author needs to clarify this point.”*

RESPONSE: The referee is right and the connection between investment international diversification and capital adjustment costs is not clear in the paper. Looking to the relevant literature it seems that there is no clear cut explanation for portfolio international diversification promoting lower capital adjustment costs. Hence, in order to avoid any misunderstanding, we would skip this argument in the revised version of the paper.

- 2) **COMMENT:** *“It is surprise that around 50% of firms have negative investment rates. Is it the usual case in Belgium? If not, does this come from the way that the author constructs firm investments?”*

RESPONSE: In addition to my response in main comment (2), I would like to note that 50% is the fraction of negative investment observations and not the fraction of firms. However, the referee is right and it seems that Belgian firms (both multinational and domestic) disinvest as often as they invest and the brushing-up of the data does not change this descriptive result. In my view, this might implies that disinvesting in Belgium is equally costly to investing and motivates the adoption of a symmetric adjustment cost function which allows equal sale-adjustment cost of capital and purchase-adjustment cost of capital. Hence I assume symmetric adjustment costs: (dis)investment responds similarly to positive and negative shocks.

Furthermore, regarding the referee’s comment on whether this descriptive statistic depends on the way firm-investment series are constructed, I would like to note that I have experimented with different capital depreciation values (5%-8%) finding similar results.

- 3) **COMMENT:** *“In footnote 20, the estimate of the convex adjustment costs by Cooper and Haltiwanger (2006) is 0.049, not 0.455.”*

RESPONSE: The referee is right and the number should be corrected to 0.049. Also in footnote 21 the estimate of the fixed adjustment cost by Cooper and Haltiwanger (2006) is 0.039 and not 0.069. We would like to thank the referee for noticing this.

“Overall, this is a very interesting and well-structured analysis. The paper may be improved if the author can put more efforts on explaining why a low capital adjustment costs results in the high negative rates of capital investment among multinational firms.”

I would like to thank the referee for her/his overall comment. I would be keen to receive any further feedback she/he would care to give in light of my responses above.