Report on “Does Foreign Direct Investments in Financial Services Induce Financial Development? Lessons from Emerging Economies”

The paper employ panel causality test and cointegration techniques to identify the existence and direction of the causal association between foreign direct investment (FDI) in financial services and financial development. The sample consists of 26 emerging economies for the period 2003-2015. The main results are: (1) there is a long run unidirectional causality from financial development to FDI financial services; and (2) financial development has a positive and significant impact on FDI in financial services.

Is the contribution of the paper potentially significant?

The topic of the paper is very relevant, since it relates the FDI in financial service with financial development, this link has not been studied in the literature. In addition, the paper has a nice discussion on this link and presents the relevant literature.

Is the analysis correct?

However, the empirical methodology is not well presented and lacks rigor. Thus, my comments and recommendations are on the empirical methodology.

Comments and recommendations:

1. There is a battery of tests on Unit root and cointegration. Each of one with its advantages and disadvantages. The paper only uses two unit-root tests, and the set of Pedroni’s panel-cointegration test. Most of the test can be summarized in two tables as in Table 2 and 3 in Aquino and Ramírez-Rondán, 2020; there is not needed to explain each test, the tables can be self-contained for that.

2. In equation (5) it is not clear who are y and X. I understood from the discussion that both are FDI in financial services and financial development; a complete equation to test is including the other variables used in the FMOLS estimation (at the end the cointegration-tests are based on the residuals of such regression), and in the causality regression analysis.

3. Since financial development does not cause FDI in financial services, I recommend for the cointegration test and the FMOLS estimator to use the specification (2) in T able 6.

4. FMOLS is superior to OLS in order to deal with endogeneity, but the other alternative one is Dynamic OLS (DOLS), it is useful as a robustness to estimate the model also by DOLS (Kao and Chiang, 2001).

5. FDI can be seriously affected by capital controls, I suggest to include the capital index measure from Fernández et al. (2016). The latest version covers the sample of the paper.

6. FDI inflows move as a results of push and pull factors. Since emerging economies are small (maybe open) economies, and then they are influenced by external factors (push

factors); as a robustness exercise, the paper can include variables such us terms of trade, China or US GDP, US uncertainty, for example (see Fratzscher, 2012).

References

Aquino and Ramírez-Rondán (2020). Estimating factor shares from nonstationary panel data. *Empirical Economics*, forthcoming.

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