

# Referee Report for “A Note on Human Capital and Feldstein-Horioka Puzzle”

## Comments

This paper takes a broader view of investment by adding human capital investment to physical capital accumulation and tests Feldstein-Horioka result by calculating saving-investment correlations. There are serious problems with this paper that can be grouped into two groups as the ones that relate to Feldstein-Horioka approach in general and the ones that relate to this paper specifically.

High degree of capital mobility is consistent with high correlation between saving and investment under complete financial markets. If financial markets are complete in Arrow-Debreu sense capital flows are zero since at the initial date there is trade on all possible future contingencies. In fact, complete financial markets imply high saving investment correlations as shown by Baxter-Crucini, 1993. Second, empirically saving-investment correlations can be high or low because of not controlling “common factors.” A better test should be running saving and investment regressions separately on country and time fixed effects and other policy variables then take the residuals and then see if the residuals are correlated or not. The intuition behind this approach is as follows. If financial markets are integrated demand of assets of a particular country depends on global supply of funds. Hence saving in a country depends on global factors and country specific factors. Global factors affect saving via global interest rate. And country specific factors that affect saving and productivity may or may not be same across countries. As a result in a world of integrated financial markets saving and investment can be correlated because of global shocks and because of country specific shocks that effects productivity and saving. If we can control for these common factors then saving and investment should not be correlated.

The authors’ approach is to add human capital, which does not solve any of the above

mentioned problems. It is also not clear how the authors measure human capital. They claim they use total expenditures for education excluding government expenditure for augmenting physical capital for educational purposes. First of all, what exactly this statement means? There is no other explanation on the data. Second of all, they also claim they add private expenditure on education to the saving part of investment-saving regressions. But then this sounds like they are adding almost the same data to both sides of the regression? If this is the case then why should we expect a change to the standard Feldstein-Horioka result at the first place?