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Comment

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Reinhart and Reinhart offer an important contribution to our understanding of the effects of large capital inflows. The algorithm they develop allows us to classify and analyze episodes of capital inflow bonanzas in a very large sample of countries, both advanced and emerging economies. The sample includes 181 countries during 1980–2007 and a subset of 66 over 1960–2007. It is the largest so far analyzed in the literature. I have two small concerns with the paper and one more interesting query.

Let us start by considering the results for advanced economies. As the authors themselves say, the results for this group of countries are less stark than for developing economies. They also seem to be driven by a few odd observations concerning not the definition of "bonanzas," but of their effects. In the data (table 6) most euro area countries appear to have experienced a currency crash (defined as an annual depreciation vs. the U.S. dollar of 15% or more) in 2005. During 2005 the euro depreciated against the dollar 12%, but beyond the size of the depreciation—which is below the 15% threshold—it is unclear whether one should relate the depreciation of the common European currency to the three bonanza episodes that occurred within a period spanning the previous 3 years: France, Portugal, and Spain (table 3). The weakening of the euro in 2005 mostly mirrored the divergence in growth between the euro area and the United States: it had little to do with the three bonanza episodes. I am similarly puzzled by two episodes of banking crises: France in 1994–95 and Italy in 1990–95. Although both events fit the definition of a banking crisis given in table 5, it is unclear whether one should relate them to a previous bonanza. In France the episode corresponds to the government recapitalization of Crédit Lyonnais, a state-owned bank that ran into trouble when it became known that, as a result of a financial scandal, it had become the de facto owner of Metro-Goldwyn-Mayer, the world's most famous movie studio. In Italy it corresponds to the state bailout of Banco di Napoli,

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a bank involved in similar financial scandals. Neither episode seems to be related to large inflows of foreign capital since both banks were state owned, thus closed to foreign investors. The significance of the results for high-income countries reported in table 7 is likely to be even smaller if these episodes were excluded.

On the role of domestic fiscal policy as a potential amplifier during episodes of bonanzas—my second small point—I share Roberto Rigobon's (2005) reservations about the identification of the procyclicality of government spending in a previous paper by one of the authors.

My more interesting query concerns the authors' view that the cycles in asset prices often associated with episodes of bonanzas should be considered a drawback of such episodes. Are they really? There is a new—and in my view very interesting—literature that suggests that large cycles in asset prices, "bubbles," are not necessarily to be avoided. Olivier (2000), for instance, suggests that speculative bubbles on equity prices, by raising the market value of firms, encourage entrepreneurship, firm creation, investment, and growth. He points to a number of technological breakthroughs that moved from the stage of a technical innovation to the stage of a new widely used technology thanks to the inflow of capital induced by the emergence of a bubble on the assets of the firms involved in the innovation. Caballero, Fahri, and Hammour (2006) investigate the feedback from increased growth to a decline in the long-run effective cost of capital, a mechanism through which "bubbles" can sustain growth. The association between bonanzas and bubbles that the authors identify is interesting per se: we disagree only (and to a very limited extent, since many bubbles, especially on real estate, are indeed a costly waste) on the assessment of the effects of a bubble.

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