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The geography of international financial flows.

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Introduction

- freeing capital justified by efficiency of investment, including into LICs.
- finance seen as leading globalisation- speed, volume and ubiquity.
- actual net flows differ from theoretical or common sense expectations.
- To clarify flows and stocks, use official and industry statistics, academic studies and pressure group arguments.

Sources

- . In 1970 national accounts for only 20 countries, showed most international movements of FDI, trade and aid.
- Since then, extended coverage countered by complexity and the use of offshore centres.
- IMF annual BoP and IIP for FDI, portfolio, bank, and derivative flows, assets, liabilities, reserves. BPM5: 25 countries reporting 1993, 80 in 2002.

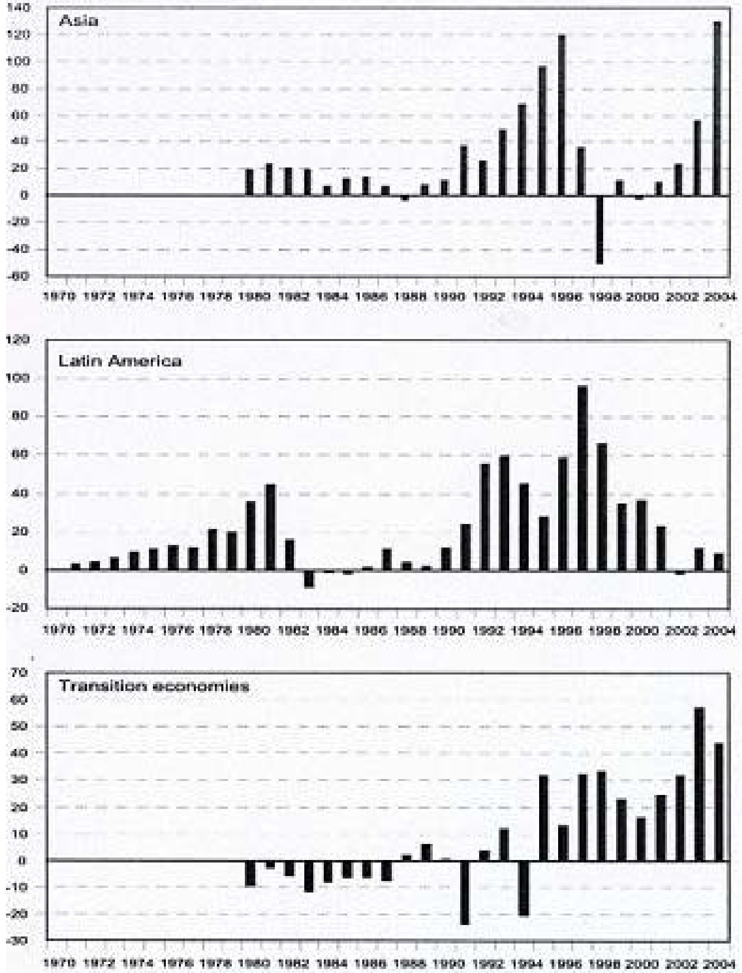
- Also used by World Bank World Development Indicators.
- Supplemented by IMF Coordinated Portfolio Investment Survey for 29 countries in 1997 and 67 from 2001
- and by BIS data on international bank assets, liabilities and movements as reported by 40 jurisdictions.
- UNCTAD World Investment Report uses a range of national, regional and international data collectors to record and analyse FDI stocks and flows.

- UN World Economic and Social Survey provides annual analyses of trends, based on IMF and WB data.
- Industry sources, notably McKinsey (2007), rest on IMF data, amended using other private and official sources.
- EWN2 (Lane and Milesi-Ferretti 2006) shows foreign assets and liabilities for 145 countries from 1970 to 2004.
- Range, variability and revision suggest identifying flows is a difficult task, and the published figures may be approximations .

Capital flows since 1970

- From 1950 to 1970, capital concentrated into developed countries, with little international movement.
- Since 1970, flows increased, mostly within and between MDCs (NB home bias), increased and volatile flows to emerging economies (Kaminsky 2005)

Figure 1:
Private capital flows to emerging markets
(Billions of U.S. dollars)



Source: World Economic Outlook 2005

Note: The countries comprising Asia are Bangladesh, China, Hong Kong, India, Indonesia, Malaysia, Pakistan, the Philippines, Singapore, South Korea, Taiwan, Thailand and Viet Nam.

The countries comprising Latin America are Argentina, Brazil, Chile, Colombia, the Dominican Republic, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela.

The countries comprising the transition economies are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Mongolia, Poland, Romania, Russia, Serbia and Montenegro, Slovakia, Slovenia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

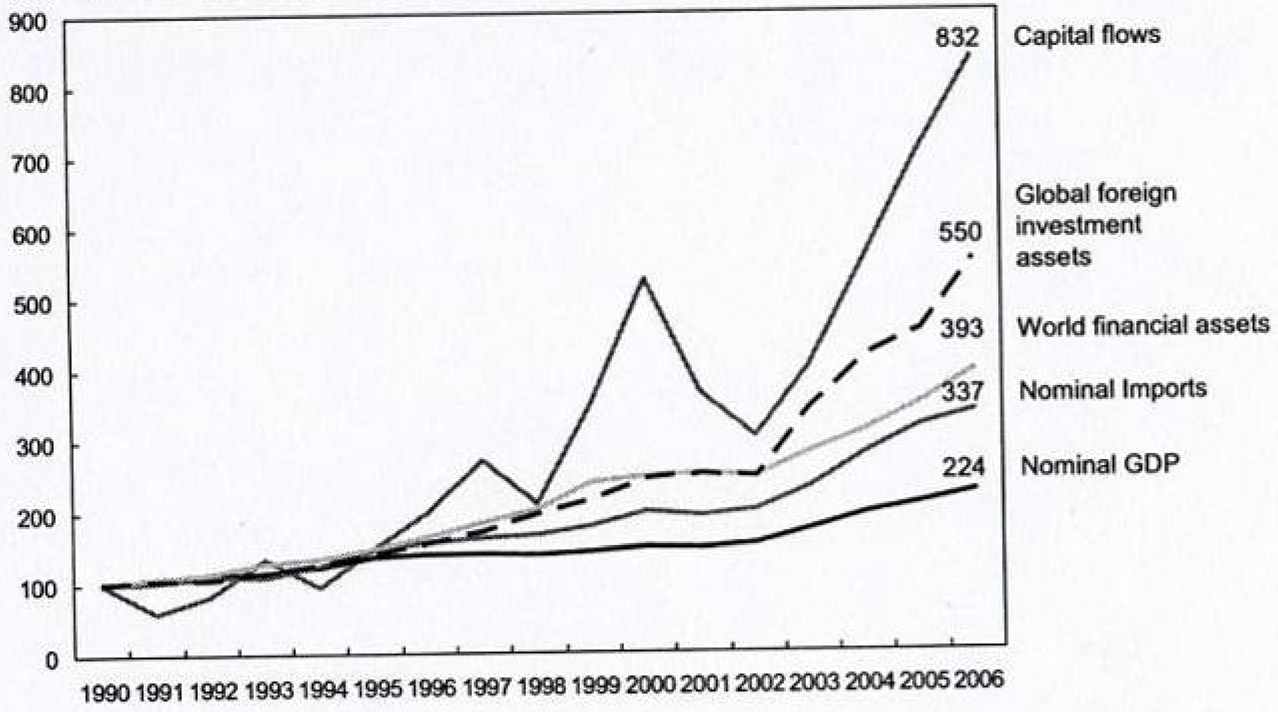
- International financial flows have grown faster than financial assets, which have grown faster than trade, which have grown faster than GDP (McKinsey 2007 p63)
- Financial assets in 2006 were $167t, concentrated in the US, Eurozone (EZ) and UK. Since 1990, assets in ldcs have grown at 21% pa, as against 8% in developed countries, but in 2006 were only 14% of the world total, as against their 23% share of GDP. (McKinsey Exhibit 2)

Exhibit 3.2

CROSS-BORDER INVESTMENT ASSETS HAVE GROWN FASTER THAN WORLD TRADE, GDP, AND FINANCIAL STOCK

Indexed growth of different economic measures, 1990-2006

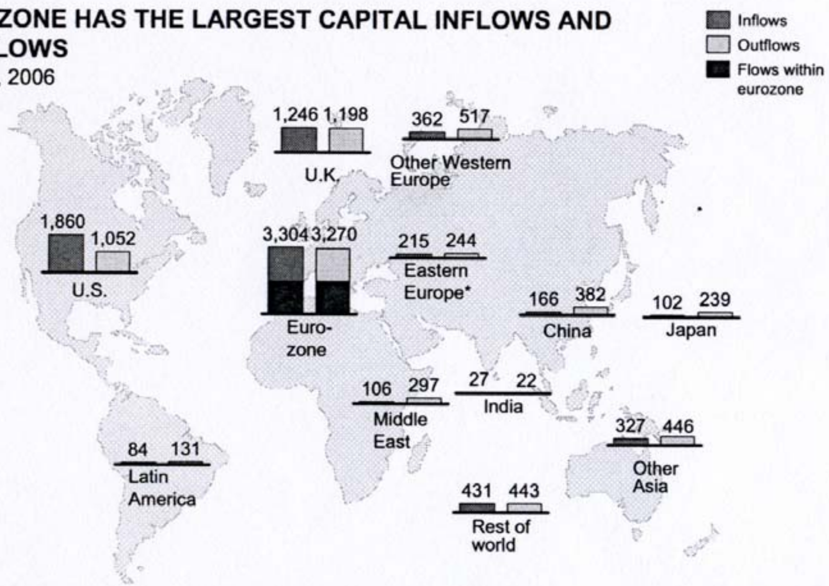
%, 1990 = 100%, constant 2006 exchange rate



Source: McKinsey Global Institute analysis

Exhibit 2.4

EUROZONE HAS THE LARGEST CAPITAL INFLOWS AND OUTFLOWS
$ billion, 2006



* Includes Russia.
Note: Outflows exceed inflows by $9 billion due to a discrepancy in data collection.
Source: McKinsey Global Institute Capital Flows Database

- Net cross border flows in 2006 were $8.2t inflows $87b greater than outflows. Inflows up $6.2t since 1996, 80% in US, EZ, UK, under 10% into ‘emerging markets’ (EMs)
- outflows of over a trillion, mostly from China, Russia, Brazil and South Korea.
- The majority of these inflows were in debt securities, bank lending and deposits, the most volatile forms of investment.
- The World Bank figures for 2005 show net inflows as $571b, but include a balancing line, reaching $345b in 2005

Table 2.1 Net capital flows to developing countries, 1998–2006

$ billions

	1998	1999	2000	2001	2002	2003	2004	2005	2006e
Current account balance	−96.7	−19.1	34.4	12.1	60.5	101.9	113.6	256.4	348.5
as % of GDP	−1.7	−0.3	0.6	0.2	1.0	1.5	1.4	2.7	3.1
Financial flows									
Net private and official flows	228.9	209.6	181.1	191.1	174.2	262.0	385.9	480.7	571.0
Net private flows (debt + equity)	193.4	195.6	187.0	164.5	169.2	274.1	412.5	551.4	646.8
Net equity flows	175.8	189.6	179.9	176.6	162.9	184.3	257.7	347.5	418.8
Net FDI inflows	170.0	178.0	166.5	171.0	157.1	160.0	217.8	280.8	324.7
Net portfolio equity inflows	5.8	11.6	13.4	5.6	5.8	24.3	39.9	66.7	94.1
Net debt flows	53.1	20.0	1.2	14.5	11.3	77.7	128.2	133.2	152.2
Official creditors	35.5	14.0	−5.9	26.6	5.0	−12.1	−26.6	−70.7	−75.8
World Bank	8.7	8.8	7.9	7.5	−0.2	−0.8	1.4	2.5	−2.4
IMF	14.1	−2.2	−10.7	19.5	14.0	2.4	−14.7	−40.2	−25.1
Others	12.7	7.4	−3.1	−0.4	−8.8	−13.7	−13.3	−33.0	−48.3
Private creditors	17.6	6.0	7.1	−12.1	6.3	89.8	154.8	203.9	228.0
Net medium- and long-term debt flows	82.9	23.3	13.4	11.6	5.8	34.8	86.4	136.2	156.0
Bonds	38.8	30.1	20.9	10.3	10.4	24.7	39.8	55.1	49.3
Banks	49.4	−5.3	−3.8	7.8	2.3	14.5	50.6	86.0	112.2
Others	−5.3	−1.5	−3.7	−6.5	−6.9	−4.4	−4.0	−4.9	−5.5
Net short-term debt flows	−65.3	−17.3	−6.3	−23.7	0.5	55.0	68.4	67.7	72.0
Balancing item[a]	−114.6	−158.1	−170.4	−122.4	−60.2	−69.1	−95.5	−345.4	−286.5
Change in reserves (− = increase)	−17.6	−32.4	−45.1	−80.8	−174.4	−294.7	−404.0	−391.7	−633.1
Memo items:									
Bilateral aid grants	42.5	44.4	43.3	43.7	50.6	63.6	70.5	71.3	70.6
of which:									
Technical cooperation grants	15.8	16.0	14.7	15.8	18.2	20.1	20.4	19.3	19.9
Other	26.7	28.4	28.6	27.9	32.4	43.5	50.1	52	50.7
Net official flows (aid + debt)	78.0	58.4	37.4	70.3	55.6	51.5	43.9	0.6	−5.2
Workers' remittances	72.7	76.6	83.8	95.3	116.2	143.8	163.7	189.5	199.0
Repatriated earnings on FDI	28.7	27.8	34.6	43.8	43.2	53.4	73.8	107.0	125.0

Sources: World Bank Debt Reporting System and staff estimates.
Note: e = estimate.
a. Combination of errors and omissions and net acquisition of foreign assets (including FDI) by developing countries.

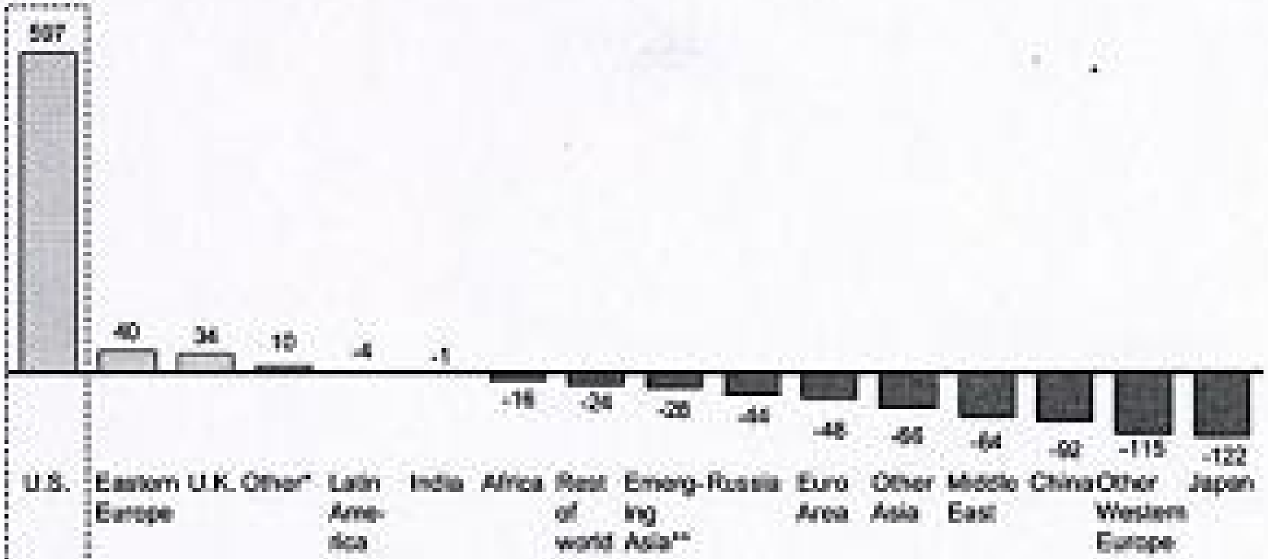
- BIS: record $26t of cross border bank claims. $3.3t were on OFCs (von Peter et al 2007). McGuire and Tarashev (2006) use lagged regressions to show intermediation of flows through IBCs. They also note large net outflows from Caribbean and Asian OFCs in the absence of commensurate inflows…
- Net flows to and from countries from 2001-2006 range from the US importing $507b pa to Japan exporting $122b McKinsey Exhibit 2.17

Exhibit 2.17

THE U.S. HAS ABSORBED THE MAJORITY OF THE WORLD'S NET CAPITAL FLOWS

Net capital importers
Net capital exporters

Average annual net capital inflows minus net capital outflows, 2001-2006
$ billion



	U.S.	Eastern Europe	U.K.	Other*	Latin America	India	Africa	Rest of world	Emerging Asia**	Russia	Euro Area	Other Asia	Middle East	China	Other Western Europe	Japan
% of GDP	5.2	4.8	1.6	0.5	-0.2	-0.2	-3.6	-1.4	-2.0	-7.3	-0.5	-10.9	-11.3	-4.6	-9.3	-2.9

* Includes Australia, New Zealand and Canada.

** Excluding China and India.

Note: Due to a discrepancy in data collection, global capital inflows exceed recorded outflows by an average of $80 billion per year.

Source: International Monetary Fund; McKinsey Global Institute Global Capital Flows Database

- ManyLICs rely on aid and remittances (Sander 2003) and suffer through past debt (Morrisey and Osei 2004)
- After 2000, net capital flows were from ldcs to mdcs, especially through Asian reserves held in US Treasury bonds (Morrissey and Baker 2003)

Summary, from Lane and Milesi-Ferretti 2006.

- Financial integration (NFA+NFL) of MDCs tripled 1970-2004, but with LDCs grew by only 50%, levelling off in the 1990s
- There was rapid growth in EM reserves from 29% of debt in 1998 to 64% in 2004
- There was dramatic growth of US net debt 1996-2004

- cumulative discrepancy between reported assets and liabilities, 6% of world GDP in 2002, c$2t,esp portfolio holdings in the USA, Luxembourg and Ireland
- Substantial (c$100billion each) unrecorded inflows to Switzerland, UK and US, and outflows from Russia, Italy, China and Norway.
- High percentages of GDP lost to countries like Mozambique, Oman, Ethiopia, Bolivia, Zambia, Kuwait and Lebanon.

- Guerin 2006 uses IMF data to show that international financial flows fit the gravity model, in that most flows are between large economies and that volumes of flow decline sharply over distance. His regressions also show that, rather than driving development, investment follows development.

Unrecorded flows

- Baker 2005 estimates £100 billion
- Transparency International identifies many billions looted from poor countries by corrupt dictators and their supporters.
- Capital moved offshore by HNWIs totals $12 trillion (TJN 2005)
- LDCs grant tax concessions to attract FDI, costing $35 billion lost tax pa (Oxfam 2000)

Unrecorded flows

- Profits moved to low tax jurisdictions by transfer pricing may reach $270 billion pa (Baker 2005) including about $3billion a year ‘moved’ from Africa to the US alone (Pak 2005)
- Since reserves are mainly held in low interest US Treasury bonds, the annual opportunity cost to LDC governments is $200 billion pa (Stiglitz 2006)

- **Conclusions**
- capital stocks and flows more concentrated into HICs, esp financial centres, than is economic activity as measured by GDP.
- Even as recorded by official data, net flows between mdcs and ldcs are small and volatile
- official data fail to record substantial flows, many out of low income countries and into financial centres on and offshore.

- Current globalisation differs from pre 1914 situation, where MDCs had large net long term investments in ldcs: most funds flow between rich countries, and are for diversification and not for development (Obstfeldt and Taylor 2004).
- Schularick 2006 adds that net flows to ldcs were a much larger proportion of their economies in 1900 than they are now.
- Even a free market enthusiast like Wolf (2004) identifies investment into (ldcs) as ‘globalisation’s biggest failure’.

- FDI positive, but only a third of investment in LDCs. Other kinds of investment are more doubtful, Baharumshah and Thanoon 2006 conclude that short term loans damaged economic growth in 8 Asian countries in the period 1982-2001.
- Since IMF staff members (Prasad et al 2003) found no evidence that financial liberalisation is necessary or sufficient to generate economic growth in LDCs, there is a need for a further review of international economic policy.

- Penetration of OFC and TNC secrecy would be a useful first step, which would also allow more accurate documentation of financial flows.

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