What Do We Know About Capital Mobility? (talking points)

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Most of the papers presented here are detailed, careful analyses and/or discussions by real practitioners of the art of managing capital flows. I won't do that, mainly because I can't – I don't have the expertise. Instead, let me present some big-picture thoughts, focusing on one key issue: the very different sense we have about the effects of two forms of globalization.

One form of globalization, illustrated by my first slide, involves trade in goods and services. Most people are, I think, familiar with the long sweep of history here. There was a first global economy, made possible by steam and telegraphs, that flourished before World War I, then was largely dismantled by war and protectionism. This global economy was then gradually reconstructed through trade agreements; but even as late as 1980 overall trade as a share of the world economy was more or less comparable to Edwardian levels.

Then something happened – containerization, better communications, the opening of emerging markets – and something new emerged, what Dani Rodrik and Arvind Subramanian call hyperglobalization. Manufacturing value chains spread around the world, and trade reached unprecedented levels.

Was this a good thing? For the vast majority, yes. My second slide is my colleague Branko Milanovic's famous "elephant diagram", showing gains by percentile of the world income distribution during the heyday of hyperglobalization. Yes, there have been problems for the advanced-country working class, and huge gains for some not very likable people at the very top. But there have also been huge gains for a huge number of previously very poor people. And don't just think China; the gains from new forms of globalization have been huge even in places like Bangladesh.

Now compare and contrast with a different form of globalization, rising capital mobility. It's harder to produce a simple number here, so I present a conceptual chart from Obstfeld and Taylor. The broad shape is similar to that of trade in goods and services: high levels before World War I, an interwar slump, and a surge after the late 1970s.

But was this surge a good thing? That's a very hard case to make, since almost from the beginning big capital flows have been accompanied by a series of "sudden stop" crises. Just to illustrate the point, I show current account balances as shares of GDP for three countries that tell the story. First, Mexico: big inflows in the late 70s and early 80s, followed by a nasty, prolonged debt crisis – and a second, fortunately briefer crisis in the 90s. Then Thailand, big inflows followed by forced transition to surpluses so large I truncated the chart. Finally, Spain – for the euro area crisis was in large part a capital-inflow-plus-sudden-stop event similar to the Latin American and East Asian crises of previous decades.

So why have things gone so badly with capital flows? One possibility involves problematic interaction with government, especially government corruption: the term “crony capitalism” was originally coined for the Marcos regime in the Philippines, where government guarantees for well-connected borrowers helped bring on a debt crisis. Another involves the inevitable link between capital flows and banking, where international flows may reinforce what we already know is a chronic problem of instability that regulation can contain but never fully defeat.

But a third possibility is simply that we are, after all, talking about asset markets, which have always been boom-bust-and-bubble prone.

The unlabeled slide shows what looks like a classic over-optimism followed by sudden stop story, and it sort of is. But as the next slide shows, it’s not about international capital flows! It’s about flows into money market mutual funds – a domestic story that looks a whole lot like the international stories we tell.

So what does it imply if we think the instability of capital flows is really just a special case of the general volatility of asset markets? Well, one thing it suggests is that international capital flows that don’t have much to do with marketable asset prices – namely, foreign direct investment, which involves control as well as ownership and is presumably more long-term in nature – should be a lot less subject to enthusiasm and sudden stops. And my last slide shows that in the case of Mexico, at least – a country I choose mainly because I think I know its history relatively well – that has in fact been the case. Foreign capital inflows in general aren’t the problem; portfolio investments may be.

The question then is how to manage capital flows to avoid the instability without disrupting the good aspects of globalization. Fortunately, that’s not a question I have to answer right now!