türkiye ekonomi politikaları araştırma vakfı

TEPAV – Towards the G-20 Meeting: Return to 1980s in Private Capital Flows

"February 16, 2009"

Economic Policy Research Foundation of Turkey

The effects of the financial crisis that emerged in the US financial markets in the second half of 2007 and spread all around the world in a short period has been increasingly felt. The fact that the crisis oriented from the financial system as well as the confidence shock it created strengthened the prospects that the most important impact will be on the private capital flows. And the decrease in capital flows is expected to affect the economy of developing countries like Turkey.

It is observed that, in the upcoming period, healthy functioning of the economies of individual countries, which have become highly dependent to one another under the effect of globalization, requires significant amount of funds. Under this context, global policy coordination becomes critical in ensuring that the acquisitions from global economic integration during last two decades will not be lost. In a period where private capital flows decrease, it will be necessary to design mechanisms to transfer funds *from one state to another and from the public sector to the private sector*. There exists a risk that, in case the economics administrations of different countries do not act in coordination when introducing measures against the crisis, the interdependence between individual economies might deteriorate to pre-1990 levels. This is a significant threat both with respect to the development perspectives for developing countries and to the protection of the current welfare levels for developed countries.

This note evaluates how the capital movements towards developing countries evolved from 1970s to present and makes some inferences pertaining to the crisis environment. The close connection between the source of the economic growth ensured in developing countries and private capital flows pinpoints that pace of growth in many countries including Turkey will be highly limited in the upcoming period due to decreasing capital flows.

Private capital movements from 1970s up to present

Financial liberalization policies observed in developing countries in 1980s paved the way for private capital movements towards these countries. In parallel with this, the ratio of private fund flows to the GNPs of developing countries, which was around 1-2 % in 1970s and 1980s, rose sharply in 1990s. The 1990-2007 period where capital movements demonstrated fluctuations can be classified under three sub periods:

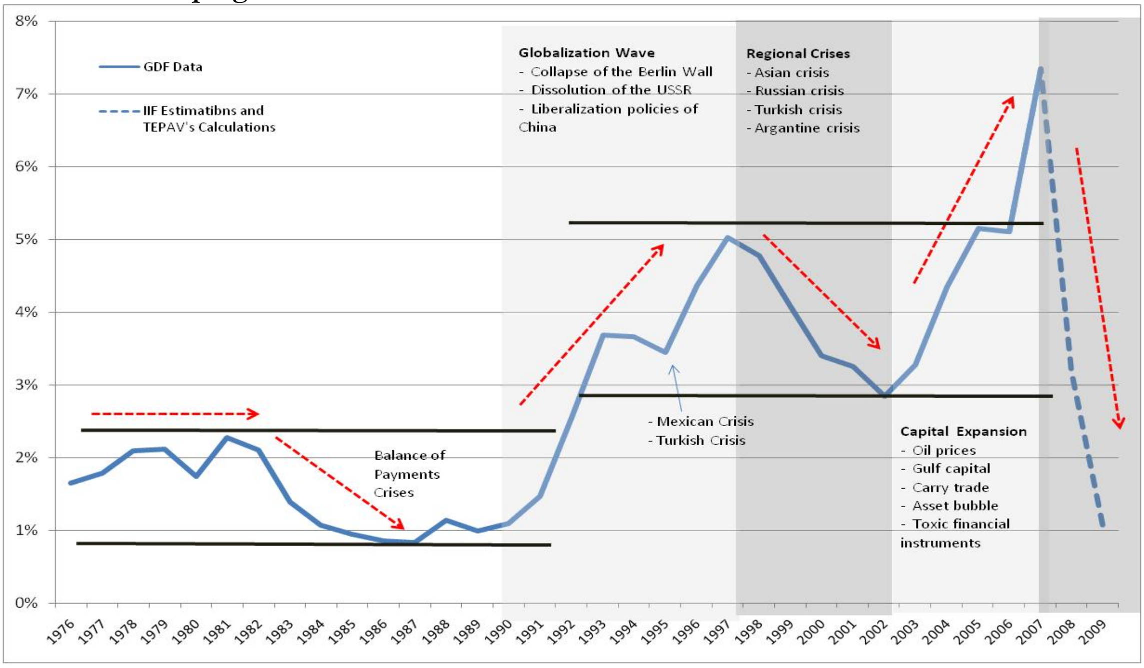
- 1990 – 1997: post-cold-war globalization wave,
- 1997 – 2002: period of regional crises,
- 2002 – 2007: period of capital expansion.

The termination of the Cold War period, the shift of former Soviet countries towards liberal economy and the acceleration of China's integration in the global economy are the important developments in this wave of globalization. In this period, the ratio of private fund flows towards developing countries to their GNP rose from 1 to 5 percent. It is also observed that, in this period, fund flows have steeply increased except for the contraction occurred as a result of the crises in Mexico and Turkey in 1994.

On the other hand, in the period of regional crisis, fund transfers narrowed down significantly in parallel with the crises that developing countries encountered one after another. The period that began with 1997 Asian crisis, crisis in Russia in 1998 and in Argentina and Turkey in 2001 created a contractionary effect on fund transfers. It is observed that, in this period, fund flows decreased from 5 to 3 percent.

In the 2002 – 2007 period, global economic integration and correspondingly capital movements were peaked. Steep increases in asset and commodity prices as compared to previous periods took place and international fund transfers reached record-high levels along with the development of new generation financial instruments. Private fund flows that amounted 169 billion dollars in 2002 reached 1.03 trillion dollars in 2007[1]. It was observed that, in this period, along with the impact of the acceleration of capital flows, developing countries achieved successful annual growth performances with rates varying between 5.6 and 7.5 percent in average. In the same period, in parallel with these developments, Turkey also demonstrated a successful growth performance with the effect of the stability program implemented and the acceleration of capital movements. As a result, the private capital flow/GNP ratio that stood at 3 percent level in 2002 for all developing countries transcended 7 percent in 2007.

Figure 1: The ratio of Private Fund Flows towards Developing Countries to GNP of Developing Countries



Global Financial Crisis and its Repercussions on Capital Flows

After the peak of the capital movements in 2007, the global crisis that oriented from the US financial markets and spread to all world economies in a short period also affected private capital movements negatively.

A report by the International Institute of Finance (IIF) notes that net fund inflow to the IIF member 28 developing countries[2] amounted 928.5 billion dollars in 2007 and

[1] Global Development Finance (GDF), The World Bank, 2008

[2] China, India, Indonesia, Malaysia, Philippines, South Korea, Thailand, Argentina, Brazil, Chile, Columbia, Ecuador, Mexico, Peru, Venezuela, Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Algeria, Egypt, Morocco, South Africa, Tunisia

this amount, though official figures are not announced yet, fell to 465.8 billion dollars in 2008. The same report reveals that IIF projects a further fall in capital inflows in 2009 to 165.3 billion dollars. It is also projected that, in line with the contraction in capital movements, average growth performance of developing countries will worsen significantly and realize around 2.7 percent[3].

In the light of these developments, it is projected that private capital flow/GNP ratio, which transcended 7 percent in 2007, will fall down to 1 percent level in 2009[4]. This implies that fund flows will return back to 1970 and 1980 levels.

Time for global coordination

The rapid contraction in fund flows will result in the loss of acquisitions ensured via global economic integration though for a temporary period. As regards the length of this period and the permanency of the damages it will create; however, there exists significant question marks. Under the current circumstances, the attempts of individual countries to announce policy packages can only partially solve the existing resource problem. In this transition period the length of which cannot be foreseen; on the other hand, there is an obvious need for devising different mechanisms to ensure the continuance of resource flows to the developing countries. Firstly, in this period where private capital movements are constrained, the need for focusing on the tools devoted to ensure resource flow between states arises. Secondly, in such a transition period, it is crucial to design the mechanisms that will transfer the international funds the public sector receives to the private sector. This indicates that, for a couple of years ahead, capital movements between states can assume a critical role in financing the global economy. However, this can be enabled only if the countries trying to take individual measures towards the crisis are turned into partners of collective solution acting in coordination with each other.

If such coordination between countries cannot be formed, it will be inevitable that developed and developing countries with large domestic markets shut the doors to the rest of the world and pursue protectionist policies. With this respect, to preserve its position in the global economy, it is critical for Turkey to address the necessity of such coordination and make contributions to this end, in particular under the scope of the G-20 platform.

[3] IIF, January 2009

[4] 2008 and 2009 private fund flows and GNP figures were set in parallel with the change rate estimations as given in the IIF report.