European Proceedings of
Social and Behavioural Sciences
EpSBS
www.europeanproceedings.com
e-ISSN: 2357-1330

DOI: 10.15405/epsbs.2020.03.98

II International Scientific Conference GCPMED 2019
"Global Challenges and Prospects of the Modern Economic Development"

INTERNATIONAL CAPITAL MOBILITY IN EURASIAN TRANSITION ECONOMIES: ACTUAL EXPERIENCE AND RESEARCH AGENDA

M. A. Sherstnev (a)*
*Corresponding author

(a) Samara State University of Economics, 443090, Soviet Army str., 141, Samara, Russia,
mikhail.sherstnevsseu@gmail.com

Abstract

The author tries to outline the key qualitative and quantitative characteristics of the international capital mobility of economies of a transitional type and gives the comparative analysis of two categories of countries taking in account the actual debates on various capital flows between developing (emerging) and developed economic systems. Financial issues of relations between developed market economies and emerging countries has been studied a lot while the situation of former socialist state needs its own analysis because of some specific features. The research is based on comparative study of two groups of the former socialist countries – the Commonwealth of Independent States and Central and Eastern European countries. The research methodology is based on descriptive statistics at the aggregate level which refers to net flows of major international capital flows in accordance with IMF Balance of Payments and International Investment Position statistics – this is the first step in such type of research. The data is derived from IMF World Economic Outlook Database Online where the aggregates of both groups of countries are readily available. The subsequent discussion offers possible interpretations for some observed distinctions in qualitative and quantitative characteristics of net international capital flows between each of the two groups of former socialist countries and tries to outline the further research agenda for this particular region of the world with specific macroeconomic, institutional and financial development characteristics.

2357-1330 © 2020 Published by European Publisher.

Keywords: International capital mobility, capital flows, transition economies, CEE, CIS.

This is an Open Access article distributed under the terms of the Creative Commons Attribution-Noncommercial 4.0 Unported License, permitting all non-commercial use, distribution, and reproduction in any medium, provided the original work is properly cited.

1. Introduction

The 1970s marked the turn from financial repression to financial liberalisation in the large parts of the world economy (McKinnon, 1973; Shaw, 1985). Capital account liberalisation as part of the process was given further impetus by the neoliberal economic policies in the late 1970s and 1980s. The next decade showed the first signs of financial instability caused by increase in international capital mobility which was accompanied by increased international integration that involved growing number of countries and regions (Stiglitz, 2002). In the early 1990s, the collapse of socialist paradigm turned former socialist countries into processes of globalisation including economic and financial aspects. A bit earlier China also took the same way. The former socialist countries joined the international institutions that are leading ones in the financial sphere – the World Bank, the International Monetary Fund (IMF), the European Bank for Reconstruction and Development (EBRD) (International Monetary Fund, 2011), liberalized their current accounts in accordance with the IMF requirements and started to free their investment transactions, most of them step by step and with caution.

2. Problem Statement

By now there is enough data to study various aspects of the international capital mobility (that already has a nearly thirty-year history) in the course of post-socialist transition, but there is obviously lack of detailed research of this kind. Financial aspects of relations between highly developed economies and countries with emerging markets have been actively studied (Fry, 1994; Golosov, 1977; Fediakina, 2005; Stiglitz, Ocampo, Spiegel, Ffrench-Davis, & Nayyar, 2006; Ocampo & Stiglitz, 2008; Chwieroth, 2010), but the case of Eastern Europe and the former USSR requires attention to interrelationships between international capital mobility and specific features of transition processes.

3. Research Questions

The key research questions of this research are as follows:

What were the qualitative and quantitative features of net flows specifically for Eastern Europe and for the former USSR in the period of 1992-2004?

What were the qualitative and quantitative features of FDI, portfolio and reserve assets specifically for Eastern Europe and the former USSR in 1992-2004;

What major risks are associated with major types of capital flows and what this means for financial stability?

4. Purpose of the Study

The purpose of the study is to provide the theoretical and methodological foundations for research on the international capital mobility in the former socialist countries which pursued the radical path of market transformation and to use aggregate descriptive statistics to outline the major trends of such mobility in the course of transition as the first step of the research programme.

https://doi.org/10.15405/epsbs.2020.03.98
Corresponding Author: M. A. Sherstnev
Selection and peer-review under responsibility of the Organizing Committee of the conference
eISSN: 2357-1330

5. Research Methods

A comparative analysis of former socialist countries in Central and Eastern Europe (CEE), Mongolia, and countries of the Commonwealth of Independent States (CIS) could be a useful approach for the study of international capital mobility. The choice of time period from 1992 to 2004 is determined by two reasons:

- in the former Soviet Union republics, radical economics transformations began in 1992;
- the former socialist countries from Central and Eastern Europe joined the European Union in 2004 and had to assimilate new economic values rules, norms and rules regulating economic relations, which at the moment should be brought into accordance with the actual legislation of the European Union.

6. Findings

The Soviet Union undertook market-oriented reforms later than the states from Central and Eastern Europe. These countries clearly benefited from the Soviet perestroika which opened to them the door of opportunity for democratic changes and peaceful social and political transformation, which in turn provided them with opportunities for determining reform ways in the course of relatively broad and open public discussion under emerging democratic mechanisms. It also should be mentioned that some countries in this region had gained entrepreneurial experience even under conditions of the socialist system in using some market mechanisms (Poland, Hungary, the former Yugoslavia, similar experiments in the former Czechoslovakia were interrupted by the Warsaw Treaty Organisation interference in August 1968). These countries from the very beginning tried to attract international investment into their economy (although they applied different ways and policies for capital account liberalisation).

The former Soviet Union undertook the attempt of political transformation prior to the market-oriented reforms which in fact failed – and in the months after the 1991 coup attempt, the collapse of the Soviet Union led to dissolution of the Soviet Union and subsequent “institutional vacuum” as newly independent states had to establish their state sovereignty (the author’s view on weak institutions and path of financial development in case of the Russian Federation see Sherstnev, 2009). There was no any solid public discussion on the choice of the reform path or any democratic consent on the matter. However, in the course of market transformation almost all former republics of the USSR were quite cautious on capital account liberalisation and took such measures in predominantly gradual manner as opposite to price liberalisation or even privatisation (e.g., such activities were fully realized in the Russian Federation in 2006 and in Kazakhstan in 2007). The severe transformation recession in the former Soviet Union in the 1990s, macroeconomic instability and low level of financial development (the wide spread barter economy and high level of foreign currency penetration as a matter of fact) created serious obstacles to inflow of foreign funds in the economies of countries in this region and had a significant impact on their structure.

Such differences in transition ways between the former Soviet Union and countries from Eastern Europe led to clear distinctions in the patterns of the capital mobility between two groups of countries. The first distinction is that Central and Eastern European countries had permanent negative current account balances and capital and financial account surpluses (it means, they financed their domestic investment by foreign savings). On average the size of the negative balance was less than 10% of GDP, but some states had

https://doi.org/10.15405/epsbs.2020.03.98
Corresponding Author: M. A. Sherstnev
Selection and peer-review under responsibility of the Organizing Committee of the conference
eISSN: 2357-1330

much larger deficits during certain periods. Unlike the CEE states, the CIS countries maintained a positive current account balance in general (during the market transformation period), and these balances grew substantially in the 2000s. It means that the countries of this region presented a financial resources source for the world economy on the whole, and its domestic investment was lower than domestic savings. And though natural resources are one obvious explanation, the phenomenon requires further in-depth investigation.

The second distinction is that financing for the CEE countries increased significantly during the accession period to some EU candidate countries in the region. On the contrary, official financing for the Commonwealth of Independent States was not significant during the whole period of conducted economic reforms (real large-scale financial support for transformations was not achieved through friendly advice and moral support from Western governments representatives and international financial organizations), though there were two substantial financial support packages during the financial crises for the Russian Federation and Ukraine.

The third distinction refers to the structure of international capital inflows. While in Eastern Europe the largest share of private capital inflows was formed by foreign direct investment, in the Commonwealth of Independent States the portfolio and other capital inflows prevailed. However, it should be noted at this point of discussion that there was some similarity in volatile nature of international capital flows in both groups of former socialist countries – they developed in waves following to the shocks of the world economy and global finance (e.g., the global 1997-1999 financial crisis or the US bursting of the dot-com bubble in the early 2000th). In addition the nature of capital inflows and outflows in CIS countries provide high level of support to ideas that they are not only highly volatile but also highly procyclical (and this was evident for all forms of capital flows including the foreign direct investment).

The above mentioned third distinction demands particular attention and some elaboration. In fact, the transition process is the process of institutional change, on the one hand, and economic restructuring, on the other. It is expected that inflow of foreign capital should serve best to achieve both objectives. The alliance between Czech Skoda and German Volkswagen offers positive example of how FDI helped to transform Skoda into global automobile brand if high reputation. The contrast was the long-lasting protectionist policies towards Russian automobile industry and primarily AvtoVAZ from global competition – when there was no clear structural policies or at least corporate plan of modernisation – which enriched certain groups of interest but later put the auto giant on the brink of collapse under market liberalization and global economic crisis. Governmental support that the company received and an alliance with Renault-Nissan which was strategically important turned out to be the late move in the right direction. At the same time, we know numerous examples when short-term portfolio capital inflows in CEE and CIS countries had negative effects. The fast growth of inflows in the periods of booms causes well known effects of expansion in lending, asset bubbles (raw materials contracts, real estate, securities). But subsequent sudden stops and capital outflows (which in fact might be caused by external causes in other parts of world economic system!) can lead to bursting of these bubbles with quite serious results for the population and the real economy sector.

https://doi.org/10.15405/epsbs.2020.03.98
Corresponding Author: M. A. Sherstnev
Selection and peer-review under responsibility of the Organizing Committee of the conference
eISSN: 2357-1330

The volatile and procyclical nature of international capital inflows and outflows causes the continuation of discussion on the desirability of capital account management measures both within the academic community and at the political level.

7. Conclusion

Different types of capital inflows and outflows – both gross and net - play different roles in economic growth and development and are determined by different sets of factors (or at least the impact of different factors has different magnitudes). The on-going research on the topic requires detailed analysis of impact of macroeconomic, institutional and financial development on different types of gross capital inflows and outflows using panel regression analysis in order to provide the solid analytical foundation for further discussion on capital flow management measures in line with the current debate in the IMF and academia.

References

Chwieroth, J. M. (2010). *Capital ideas: The IMF and the rise of financial liberalization*. Princeton, NJ: Princeton University Press.

Fediakina, L. N. (2005). *Mezhdunarodnye financy*. St. Petersburg: Piter. [in Rus.].

Fry, M. J. (1994). *Money, interest and banking in economic development, 2d ed*. Baltimore, MD: Johns Hopkins University.

Golosov, V. V. (1977). *Teorii vyvoza kapitala*. Moscow: Mysl. [in Rus.].

International Monetary Fund (2011). Recent experiences in managing capital inflows – Cross-cutting themes and possible policy framework – Supplementary information. Retrieved from: https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Recent-Experiences-in-Managing-Capital-Inflows-Cross-Cutting-Themes-and-Possible-Policy-PP4543 Accessed: 21.09.2019.

McKinnon, R. I. (1973). *Money and capital in economic development*. Washington, DC: Brookings Institution Press.

Ocampo, J. A., & Stiglitz, J. E. (Eds.) (2008). *Capital market liberalization and development*. New York: Oxford University Press.

Shaw, E. S. (1985). *Financial deepening in economic development*. New York: Oxford University Press.

Sherstnev, M. A. (2009). Russian Banking in Transition: Survey and Synthesis. International Finance Review, 2009, pp.215-262.

Stiglitz, J. E. (2002). *Globalization and Its Discontents*. New York: W. W. Norton & Company.

Stiglitz, J. E., Ocampo, J. A., Spiegel, S., Ffrench-Davis, R., & Nayyar, D. (2006). *Stability with growth: Macroeconomics, liberalization and development.* Oxford: Oxford University Press.