

Globalization, Capital Flows and
Macroeconomic Policy Issues

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Macroeconomic Policy Issues**

by

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Abstract

This paper attempts to describe the character of the globalization taking place in the world economy today, the role of foreign (short-term and long-term) capital in it, and the macroeconomic policy issues that evolve from it. Though macroeconomic policy issues imply a wide range, the focus is on trade and exchange rate, monetary and financial, and some institutional components.

As a starting heuristic point, globalization has taken on many forms - from the globalization of production to the globalization of labor markets. In recent years, these have changed in configuration and have spread more broadly across many trading nations. What permeates among them is the critical role of foreign capital aside from the fact that there has been a globalization of capital itself.

Selected evidence from a number of Asian countries that have experienced short-term capital financial problems indicates that the picture of short-term capital when broken down into their traditional components is becoming hazy. Yet their impacts have been pronounced even in countries which have recognized their potential volatility and even after imposing some form of controls.

The macroeconomic policy issues that confront trading countries need to be clearly sorted out. First of all, foreign short-term capital plays an important catalytic role in the globalization process with trade and investment more integrated than before. Reinstating capital controls is tempting but their effect on the other parts of a country's trading system has to be fully understood. Second, exchange rate policy has to be reconsidered in terms of either abandoning it or allowing more market forces to dictate it thus freeing monetary policy to address other objectives. Finally, the institutional changes are formidable and have to be examined.

The paper's main point however is that the macroeconomic policy issues surrounding globalization and short-term capital suggest a retreat to the fundamental macroeconomic foundations of the economy. With some amount of institutional reforms in the monetary side, short-term capital may become a more positive component of globalization contributing to a more integrated trading system.

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Florian A. Alburo

1. Introduction and Summary

This paper attempts to describe the character of the globalization taking place in the world economy today, the role of foreign (short-term and long-term) capital in it, and the macroeconomic policy issues that evolve from it. Though macroeconomic policy issues imply a wide range, we want to focus on trade and exchange rate, monetary and financial, and some institutional components.

As a starting heuristic point, globalization has taken on many forms - from the globalization of production to the globalization of labor markets. In recent years, these have changed in configuration and have spread more broadly across many trading nations. What permeates among them is the critical role of foreign capital aside from the fact that there has been a globalization of capital itself. Long-term capital seems to remain a stable part of global capital but short-term capital has taken on new shapes and forms. Moreover, with the advent of instant and real communications across financial markets, it has not been easy to track down short-term capital. Indeed, with new instruments, new options, and new mechanisms, short-term capital changes character often quickly as market opportunities dictate. This creates difficulties in terms of the macroeconomic policies they bear, and suggests that the issues could have widened with serious consequences for countries in terms of their abilities to chart a stable growth process.

Selected evidence from a number of Asian countries that have experienced short-term capital financial problems indicates that the picture of short-term capital when broken down into their traditional components is becoming hazy. Yet their impacts have been pronounced even in countries which have recognized their potential volatility and even after imposing some form of controls.

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macroeconomic foundations of the economy. With some amount of institutional reforms in the monetary side, short-term capital may become a more positive component of globalization contributing to a more integrated trading system.¹

2. Globalization and Foreign Capital

When we speak of globalization of goods markets, the reference is for a singular market for them, and any price differences are due to locational differences not market segmentation. More accurately, markets are becoming globalized by virtue of the narrowing of price differences for commodities across the world. Indeed the array of goods for which markets are globalized seems to be more widespread rather than sporadic and covers more countries and regions. This type of globalization has been spurred by several factors including the sweeping economic reforms in many non-market economies from Eastern Europe to the Indo-Chinese states, deregulation carried out in many trading countries that stimulated efficiency improvements and changing prices, and privatization being pursued allowing more private sector initiatives in international economic transactions.

What seems to underpin this globalization of markets is a simultaneous globalization of production that firms now practice where their behavior vis-a-vis other firms, suppliers, and consumers dictate trade patterns. This globalization of production is being shaped by two forces - technology revolution that has changed in properties (shorter life cycle, greater emphasis in re-engineering, and higher investment outlays for its creation), and information revolution that has also changed in properties (real time, universal, and lower costs).

The overall characteristics of this globalization have been described elsewhere (Simon and Jun, 1995; Naisbitt, 1994). What is important to point out here is that the nature of investment, especially foreign direct investment, differs markedly from the way past investments behaved. For one, the technology-intensive competition among a number of industries, e.g., electronics, telecommunications, mechanical tooling, and machinery, indicate more heated investments to reap early profit gains that drop quickly. But the cost of investments has made global firms seek new and more partners to share risks and add value. Thus there is keen competition to move funds as quickly as possible. For another, the forms of investment have widened considerably beyond the simple equity purchases of the past and have taken new forms (Oman, 1984). Finally, the declining life cycle of products and the narrowing of income differences among trading countries have stimulated the changing patterns of investments.

There is also a globalization of labor markets that is supposed to be slowly taking place among trading nations. As the industrialized and industrializing economies experience tight labor markets, as some of these cope with aging, and as housewives participate in the labor markets, there will be a tendency for labor to move across boundaries. Though much of the labor movements have combined legal and illegal

means, what is true is that there is passive tolerance among the recipient countries. In fact, the phenomenon of "guest workers" is reflection of the tolerance (Memedovic and others, 1997).²

What is important to point out is that the globalization of labor markets entails financing requirements involving foreign capital. The emergence of placement agencies that are joint ventures between source country and destination country firms is evidence of this. And in many instances these are short-term arrangements mostly on a project basis instead of a continuing track. Over and above the response by labor sectors to the liberalization of labor markets is the adjustments that labor-abundant and labor-short countries take. In the former would fall searches for both increasing labor supply through further capacity generation and moving up the skill scale through capital investments. In the latter there is also search for further means of capital-labor substitution that would reduce the need for labor imports as well as reduce the need for moving production operations overseas where labor is abundant. Whatever would be the net effect of these adjustments do not diminish the overall capital requirements including foreign capital resources.

In the course of globalizing labor markets, the rising incomes among temporary migrant and guest workers open opportunities for foreign investment instruments to flourish. This is especially true in places where there are large concentrations of temporary workers. For example in Hong Kong it is widely known that workers participate actively in the stock markets.

The globalization of capital markets is supposed to be the epitome of globalization. The mobility of capital has integrated financial markets among trading nations, added more vehicles for investments to locate where returns are highest, and increased access to resources for capital-short countries. Indeed the globalization of capital markets is said to be reflected in the movement of capital prices being the same across global financial centers.

The evidence however indicates that this globalization is not really true (Economist, 1997). While the index of capital controls in emerging markets may have dramatically declined between the mid-eighties and 1996, net capital flows have expanded rapidly, and their importance to overall investments has increased, it is not true that yields of capital (real bond yields) have narrowed considerably, even among industrial countries. Real globalization of capital still has a way to go.

It is not quite useful to look at the globalization of capital markets in isolation from the broad direction of globalization taking place and which has been summarized here. In particular, the real commercial transactions taking place among trading countries are the setting for capital to move and to assume a variety of modalities. And the degree to which capital moves or changes configurations is a function of the real economy.

In several senses, however, foreign capital plays a unique role in the globalization phenomenon. First, it fills the gap between savings and investment. In general, with the exception of a few countries, foreign investment is only a small share of total investment carried out in developing countries. In fact, if there were capital integration, we would see an insignificant relationship between saving and investment since foreign capital can always fill the gap but yet the relationship remains though over time it may have diminished. Second, foreign capital brings with it technology, managerial innovations, and other "shift" factors that raise the country's overall productivity and competitiveness. Foreign capital may be bundled with other elements of development. Finally, with open capital transactions, capital-short countries can participate in tapping the markets of other countries in search for capital resources.

Traditionally, foreign capital is distinguished according to whether it is long-term or short-term (or medium-term). For Balance of Payments recording, this traditional classification has been followed with time period being the dividing line in the classification. In recent times however there may be reasons to doubt this traditional classification. The increasing privatization of capital transactions and the liberalization of capital markets have expanded the scope of foreign capital use and the time period within which such flows take place. In some cases the initial transactions takes one mode but quickly transforms to another mode subsequently.

On the other hand, foreign short-term capital has traditionally been taken to be accommodating i.e. serves as trade credits and financing of trade transactions.³ Except under certain circumstances this element of the Balance of Payments has remained stable over time. Along with other components (e.g. gold movements, Special Drawing Rights, etc.), disturbances to the flows could be fairly predicted.

With the advent of globalization however short-term capital has been anything but traditional. Indeed the whole notion of capital has taken on new meanings as the function of globalization has escalated. New instruments and new market opportunities have dictated the manner of capital movements across the globe. No longer are capital confined to financing trade or taking on longer term equity participation but a wide gamut of modalities unheard of before. As countries open their economies to global transactions and commerce, the manner of capital participation has opened up as well. And as we pointed out, this has dictated the configuration of capital flows.

While the tradition of foreign capital classification may have been broken, medium and long-term capital seems stable especially where these have been mediated through government guarantee or syndication. What has taken on all sorts of changes are in short-term capital. Moreover the actual location of short-term capital has been important in determining the complexities of transactions.

3. Short-Term Capital Flows: Impact and Evidence

As a general observation, it appears that it was not until 1990 that capital flows, especially to developing countries, acquired a life of their own distinct from the traditional role they have played in the Balance of Payments. This is noteworthy with respect to the flows to Asia. Table 1 shows the capital flows to Asia between 1970 and 1992 which tend to show (a) the share of Asia to total world capital flows increased from 25.5 percent to 42.1 percent, (b) the decline of official loans in the composition of flows during the same period, and (c) the emergence of portfolio equity and bonds as part of these flows.

In comparison with the flows to Latin America, characterized by continuous debt-equity conversions, privatizations, and the importance of the United States as major sources of these capital, those that went to Asia mostly came from Japan. Table 2 shows the international claims by nationality of reporting banks for 1993.⁴ For all of Asia more than 40 percent of capital were claims by Japan followed by a wide distance by France (10 percent) and the United States (9.6 percent). It is only in the Philippines that U.S. banks had larger claims than Japanese banks.

Several factors account for these observations. Privatization of many state enterprises in the region stimulated the development of securities markets. As these firms were publicly offered, the rest of the world became aware of investment opportunities elsewhere. For example, Singapore Telecom privatization in 1993 doubled the number of investors in Singapore to 1.5 million or half the population of the country. Similarly the listing of Chinese companies, IndSat of Indonesia, HOKO Steel of Korea and even earlier the First Philippine Fund in the New York Stock Exchange enhanced global investor interests in Asia (Fuchita, 1995).

The surge in stock market activities in the Asian region brought in more capital flows. With market values increasing multiple-fold in many Asian countries, even more capital flowed in to reap early profits from the markets. Consider the market value increases for a number of Asian stock markets between 1990 and 1993: Indonesia from \$ 1.1 B to \$ 33 B, Malaysia from \$ 48.6 B to \$ 220.3 B, Philippines from \$ 5.9 B to \$ 40.3 B, Singapore from \$ 34.3 B to \$ 133.8 B. This is not to mention Asian markets which while already operating found themselves with increased market values as well (e.g., Hong Kong, Korea, and Taiwan).

In much of the nineties, the Asian countries had also participated actively in the globalization of markets described earlier. This necessitated the creation of new enterprises requiring corporate finance, project finance and start-up capital for which domestic institutions were inadequately prepared to supply quickly. This of course attracted capital flows given the fact that Asia had no problem with debt (compared to Latin America). Indeed one can see a significant shift in the composition of external debt in many Asian countries from publicly acquired to deposit money banks (see Table 3).

Then there was a spate of financial liberalization among Asian countries where the banking sectors were opened to foreign investments. Indonesia's financial deregulation in 1988 led to a surge of Japanese bank affiliates establishment in that country (from 0 to 10 in 1990). In Thailand, Malaysia, and the Philippines, offshore markets were opened and foreign banks were allowed to operate branches for the first time. There was an even open door policy in China and Vietnam.

In part the emergence of these new markets led to a growing base of bond issuers in the region. Whereas the first dragon bonds were issued by the Asian Development Bank in 1991, GE Capital followed soon thereafter and then other issuers (e.g., Chinese Finance Ministry bonds issued in 1993). In fact the definition of dragon bond expanded beyond being subscribed, priced and listed in the exchanges of the financial centers of Hong Kong, Singapore, and Taiwan to encompass all bonds listed in the Asian markets. Indeed Japan's investment in Asian stocks led to net purchases in 1993 compared to being net sellers before. Japanese purchases of Asian stocks were 25.7 percent of all purchases in 1993 compared to 4.2 percent of all purchases in 1990.

Finally, Japan played an important role in the movement of capital in the Asian region. For one, it was suffering from a prolonged recession in the early nineties combined with a trade surplus. This of course resulted in a search for profitable markets for excess funds. Asia was closer than the countries in the Western Hemisphere. Thus, except for the Philippines, Japan's exposure to the Asian movement of capital was substantial and in various forms.

The wide menu of capital flow instruments that have evolved in the Asian region makes their classification fuzzy and not easily tractable. In part this is because both investors and recipients can always move from one type of capital instrument to another without difficulties. A look at Figure 1 showing the flow of foreign direct investment in some Asian countries indicates that FDI flows have been erratic since around 1992, with Korea exhibiting sharp decline since 1993. Figure 2 shows the portfolio capital but with similar fluctuations since 1993. Figure 3 tracks other short-term capital which has even wider fluctuations. The net of all these flows are shown in Figure 4. This figure seems to portray more consistent flows to these countries during the period of the early nineties. With all the various forms of capital transactions taking place, using any one of the traditional measures fails to reflect the magnitude of capital movements taking place. This is observable in the period beginning 1990.

There is another way to look at the hazy picture of capital inflows according to traditional classification. Table 4 shows a breakdown of capital flows for selected Asian economies into what is considered their major component i.e. direct investment. What we find here is the diminishing importance of direct investment after the initial spurt of net capital flows. This is true for many of the economies except for Singapore. All the others show the greater importance of other net capital flows to the total capital inflows, a case where the main component is less than the catch-all variable.

Another reason for these varying fluctuations of capital flows is the need for comparability. At the country level, the data may be more consistent and thus show trends that are stable. This is not really true since countries have experienced changes in the modes of capital flows as markets have matured and as business transactions have reached new heights.

In summary, the surge of capital flows into Asia has no doubt played a critical part of the growth performance of the region's economies. These flows have facilitated the increased integration of the economies to the globalization processes. The emergence of new enterprises in the region has been supported by the access to capital resources from abroad without which would otherwise hamper the overall development. Indeed the many factors identified here combined to make the region an attractive host to foreign capital and along with Japan's response, they have contributed to a credible economic performance of the region's economies.

On the other hand, these foreign capital flows effectively impose costs that are not the same as domestic capital. For one, these are denominated in foreign exchange under given exchange rates. From the viewpoint of debtors therefore the returns must be such that they pay for the principal in foreign exchange terms after maturity and still be profitable for the enterprises. If in the interim the exchange rate changes and the transaction is not covered, the capital flows are not rolled over, or restructured, they impose a debt burden larger than otherwise.

Where the capital flows are undertaken for export enterprises earning foreign exchange, there is less risk from possible changes in the exchange rate since the earnings would repay the debts in the same currency. Where these are undertaken for domestic enterprises possible exchange losses are added risks. More pointedly, since capital flows are effectively additions to the money supply as if domestic enterprises borrow from the domestic banking system, they really potentially impose a "social cost" that society as a whole may "pay" in the event of exchange rate changes.⁵

To the extent that a country pegs its exchange rate, and succeeds in doing so, there is greater certainty that capital flows would continue to move in and out of the country. But where there is volatility in the exchange rates over and above the behavior of hedging facilities capital flows would be affected in negative ways. In short, the foreign exchange market is an added dimension to the character of capital flows.

The recent currency crisis in Southeast Asia is a clear manifestation of the double-edge nature of capital flows. What triggered it was much a fundamental flaw of the capital flows system as much as the perception among traders that the time to leave is soon. Firstly, there has been a dramatic fall in the nominal exchange rates among the Asian economies especially when compared to rates one year before suggesting the peg adhered to by them. Secondly, there has been a crash in most of the stock exchanges especially when compared to their levels at the start of the surge of capital flows to the region. If one looks at the stock exchanges indices, the 1990 levels have been reached in a

matter of days. Finally, the crisis has been exacerbated by virtue of the overreaction of the financial system to the withdrawal of foreign capital from the region.

The foreign capital fallout experienced by a number of the Asian economies even in countries which have had sustained economic growth in the last decade shows their vulnerability to external transactions. Indeed, these attacks strike at the very core of economic fundamentals - whether healthy or shaky. Yet this is the nature of foreign capital. Their effects are symmetrical positively and negatively.

What the crisis brings to fore is the macroeconomic policy issues of capital flows and how policy makers address them. Given the dynamic changes in the character of these flows the issues become dynamic as well. It is not that there have been no parallel historical experiences, as the events of the Mexican crisis reveal, but that there have been unique conditions in the Asian region (see Siamwalla, 1997 for a comparison of the Thailand and the Mexican crisis).

The relative inexperience of the Asian economies in managing the macroeconomic aspects of liberalization combined with the surge of foreign capital have made adjustments doubly challenging. What we want to do is discuss a few of these as they relate to the current fallout in the region.

4. Macroeconomic Policy Issues

In this section we want to focus attention on three policy issues that often come up during surges of foreign capital. These involve domestic monetary expansion, the independence of monetary policy, and options open as one set. Then there are issues associated with exchange rate policy and the extent of financial liberalization as another set. Finally there are the institutional policies and reforms related to the banking system.

The inflow of foreign capital usually leads to an expansion of the monetary base as domestic borrowers convert foreign currency into local currencies. The central bank monetizes these flows setting off further expansion of the money supply. The unpredictability of foreign capital flows makes monetary policy almost arbitrary and tied to the global flow of funds. The issues therefore revolve around whether to automatically expand the monetary base, institute sterilization procedures, impose restrictions, or some combination. Much of the actual responses may depend on the existing macroeconomic conditions. Invariably many countries in the region practiced a combination of these. The classic sterilization procedure involves monetization simultaneous with open market operations where the government sells Treasury bills and other instruments to reduce the domestic component of the monetary base offsetting the reserve inflow. However this leads to a rise in domestic interest rates which in turn induce further inflows which were the initial object of the policy. In the case of the Philippines the amount of sterilization is often less than the magnitude of the reserve flows, as its experience with the early inflows shows. Among the countries in the region, Singapore and Taiwan had exercised

conservative sterilization. Of course the success of the classic type of policy depends on the degree of financial integration and mobility of outward capital movements e.g. the liberty to retain export earnings abroad. In the case of the Philippines the partial sterilization took place while their continued restrictions to the retention of export proceeds which were only gradually liberalized.⁶ Consequently domestic credits rise. Table 5 shows the pattern of domestic credit change to foreign reserve accumulation as a result of capital flows. Figure 5 shows the growth of domestic credit in the Philippines since 1994.

Because of the size of capital flows, the complexity of their modalities, and the potentially large fiscal cost of sterilization, what is often resorted to is a range of supplementary measures that still accomplish sterilization. In response to speculative flows in Malaysia in 1993 and 1994, the Central Bank imposed a negative interest rate on foreign *vostro* balances (Ong, 1995). Chile in 1991 raised a special deposit on external borrowing to reduce the attractiveness of capital inflows. This applied to all external financing flows including credit lines, deposits, loans, and bonds. Accordingly, during the stock market falls in Latin America between December 1994 and February 1995, Chilean stock prices in dollar terms fell by 2.2 percent compared with falls in Brazil of 49 percent, Argentina of 49 percent and Mexico of 69 percent. Deposit requirements are a form of tax on borrowings from abroad which do not have a direct impact on domestic interest rates, discourages further capital inflows, and can be varied in imposition in terms of time period. Though behaviorally borrowers eventually find a way around the deposit requirements this seems to have been effective in the short run.

The more administrative types of issues related to capital flows consider outright capital controls, and other forms of direct intervention. This of course sets back the liberalization route associated with globalization. It is of course true that the various forms of capital flows are hardly distinguishable so that an instrument meant for speculative flows affects all other "desirable" flows. The point is that one does not take advantage of the capital flows' positive effects in good times and impose conditions during bad times.

Reserve requirements would open up another macroeconomic policy issue. In general however while reserve requirements may sterilize capital flows similar to open market operations without their side effects, much depends on whether interest is paid on the reserves, how much banks already have set aside for reserves, and the relative desirability of creating stability in the banking system through a constant reserve requirements invariant with capital flows.

If the exchange rate is pegged, monetary policy loses some independence in as much as the authorities are committed to buy or sell foreign currency at the pegged rate. This is especially true when combined with capital mobility. The next set of macroeconomic policy issues concern exchange rate policy.

Without having to delve into the larger issues of the exchange rate, what is relevant to capital flows are two opposing directions. The surge of inflows tend to appreciate the currency. The Central Bank stands ready to exchange domestic for foreign currency at a pegged rate which assures money traders that the exchange rate will continue. On the other hand there is the temptation to allow an appreciating currency to hold inflation down. This may ward off further capital inflows but affect the real side of international transactions.

The Central Bank may also use the foreign exchange market to effect sterilization of capital flows. By promoting foreign exchange swaps (agreeing to buy forward at a rate higher than the interest rate differential), the effect is the same as open market operations in the domestic market. Obviously pursuing this option can impose losses for the central bank. It is known for example that one reason for the July 2 depreciation of the Thailand Baht was the large amount of forward sales of dollars which were not recorded against reserves (Adams and Vernon, 1997).

In all, exchange rate policy in a regime of capital flow surges generates issues that need to be sorted out. What is clear is that over time they erode the real competitiveness of the economy which makes it more dependent on foreign capital to shore up overall balance of payments while the trade balance and current account further worsens. This is all good as long as the economy (and the specific projects which the foreign capital finances) generates the necessary foreign exchange though not quite so if the deficits are financed by short-term capital flows. Unfortunately what happens is that the appreciation of the currency (partly from the inflows themselves and partly from the need to hold inflation down) reduces international competitiveness.⁷

If the exchange rate is pegged to the US dollar (as most Asian currencies have been) and it has seen some appreciation as a result of capital flows there is a tendency for an overvaluation of the currency. Now add to this the appreciation of the currency to which it is pegged and the overvaluation would be larger. The Philippine peso appears to have suffered severe overvaluation coming from several sources: (a) a lingering overvaluation from the past, (b) surge of capital flows which appreciated the currency, and (c) appreciation of the US dollar.

An important set of policy issues may be more institutional than macroeconomic in nature. The increasing involvement of non-bank financial institutions in the mobilization of foreign capital makes them difficult to track since in some countries like the Philippines these are not regularly captured in Central Bank books and statistics. In the end though these institutions act as vehicles for capital transactions.

Banking policies need reforms ranging from prudential regulations to disclosure and greater transparency. This is compounded in some developing countries which practice personality-based commercial transactions effectively setting aside objective and deliberate calculation of project viability. In some cases there is pure cronyism in the allocation of credit. The history of the Philippines is a stark example of how this practice

wreak havoc on the economic system. Open information, which the Philippines regained after 1986, serves well in sensitizing the business community about the problems with foreign capital transactions that do not rely on calculations of benefits and costs.

More efficient capital account management can not be achieved without a well functioning financial markets, adequate supply of marketable instruments that are good substitutes for each other, and integrated markets (Lee, 1997). Indeed if countries actively participate in the globalization processes, they must have active participation as well in the mobilization of foreign capital.

5. Concluding Remarks

The various forms of globalization taking place in the world today require foreign investments. The recent surges of capital flows however have elements that take advantage of the emerging markets - from stock markets to short-term debt financing. It seems clear that many of the factors that have led to capital flows are facilitative of the globalization processes. And in Asia, new enterprises, corporate finance and project finance are dominant users of foreign capital partly in the context of global production.

In the consideration of macroeconomic policy issues, retreating to the fundamentals appears to be a direction that will continue to support the process of further economic integration through the globalization of goods and factor markets, rather than the option of restrictions and controls in order to recover from currency crisis and attacks on the emerging economies. These fundamentals include further liberalization especially of financial markets that would encourage efficient two-way flows of capital, temporary instruments that tend to equalize returns from borrowing and lending, and the freeing of foreign exchange markets that eventually depart from pegged exchange rates. The countries in the Asian region seem to be following this retreat to basic fundamentals. After all the foundation of these economies remain strong.

This does not mean that there are no concrete agenda for reforms and institutional changes that would improve a country's ability to manage capital flows. The macroeconomic issues to consider include monetary policy options that would mitigate the potentially adverse effects of foreign capital, exchange rate policies that would strike a balance at maintaining competitiveness with reducing the undue appreciation of the currency, and institutional changes that would better the environment for capital flows in terms of information, regulations, and other measures to tighten monitoring and surveillance of principally the banking sector as the conduits for capital flows.

Most of the macroeconomic issues are not new. Yet in the light of threats to the process of globalization taking place, it becomes imperative that these issues be considered and that the affected countries take stock of them in the process of defining adjustment measures. The macroeconomic issues in foreign capital can not be removed from the issues related to trade and globalization.

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ENDNOTES

- ¹ This is not meant to say that long-term and medium-term capital have already been wired into the globalization process.
- ² In a sense, when temporary migrant workers return with newly learned skills, they would probably require capital resources to establish enterprises and foreign partners as appropriate.
- ³ Traditionally, capital accounts fall below the line in the balance of Payments.
- ⁴ We use 1993 as a cut-off year after which capital flows had surged even faster.
- ⁵ It might be argued that even if private transactions cause a currency run and thus ought to be left to the private sector there are social costs to the whole financial system which may have to be supported.
- ⁶ In fact as late as 1992, Philippine exporters were only allowed to retain 5 percent of their export earnings in foreign currency.
- ⁷ With the abandonment of the peg by the major Asian economies, Hong Kong remains committed to the US dollar. How long it can last and aim to remain competitive is not clear but it probably becomes more vulnerable to further currency attacks.

Table 1

Capital Flows to Asia (1970 - 1990)

	1971-76	1977-81	1982-88	1989-92
Asia (B \$)	10.5	24.6	43.3	73.8
(percent share)	(25.5)	(22.2)	(34.5)	(42.1)
Composition (percent share)				
Foreign Direct Investment	8.9	8.9	13.2	22.4
Portfolio Equity				3.9
Bonds	0.7	1.4	8.2	3.9
Commercial Bank Loans	21.3	30.9	31.5	23.0
Suppliers Export Credit	9.2	11.9	10.2	10.9
Official Loans	42.2	36.0	32.7	29.8
Grant	17.7	10.8	7.2	5.7

Source: IMF World Economic Outlook, 1994.

Table 2

**International Claims by Nationality of
Reporting Banks
(percent)
1993¹**

	Japan	US	UK	Germany	France
Asia	40.9	9.6	8.1	6.3	10.0
China	39.7	2.2	6.7	5.5	16.2
Indonesia	54.9	8.1	5.9	5.4	7.7
Korea	29.9	10.4	10.0	7.0	7.7
Malaysia	41.1	9.8	13.8	7.4	8.6
Philippines	16.6	44.1	10.3	2.7	6.6
Taiwan	26.8	16.1	9.7	8.5	16.5
Thailand	55.2	7.9	5.7	6.2	6.2
HongKong	66.1	3.0	4.9	7.3	4.5
Singapore	58.8	3.3	7.3	9.6	3.9

Source: BIS

Table 3.1
Composition of Total External Debt by Borrower
(in percent)

	End of 1985			End of 1993		
	Public Sector	Private Sector	Deposit Money Bank	Public Sector	Private Sector	Deposit Money Bank
Korea	48.9	15.6	35.5	27.7	44.6	27.7
Taiwan	47.2	19.5	33.3	1.3	49.7	49.1
Singapore	10.8	12.6	76.6	0.1	11.9	88.0
Thailand	60.2	30.3	9.5	31.1	53.5	15.4
Malaysia	65.2	22.0	12.8	40.0	23.6	36.4
Indonesia	71.6	27.0	1.4	54.8	36.4	8.8
Philippines	72.3	17.0	10.7	78.3	15.7	6.0
China	70.6	-	29.4	74.5	-	25.6
Mexico	64.7	16.6	8.8	68.7	16.3	15.0
Chile	73.9	12.6	13.6	57.1	28.0	14.9
Colombia	76.0	14.2	9.8	82.2	10.2	7.6
Peru	94.2	3.7	2.1	95.5	3.3	1.1

(*) Figures for Singapore, Thailand, Indonesia, Philippines, Colombia, Peru are as of 1992.
Figures for China, Chile and Mexico are estimated.

Source: Ikeda and Ito (1995).

Table 4
 Composition of Net Capital Inflows

		Year of Capital Inflow Episode*			
	Average of Two Prior Years	0	1	2	3
Indonesia (1990)					
Total Capital Inflows, net	1.6	4.9	5.3	3.8	1.8
Direct Investment, net	0.7	1.0	1.3	1.4	1.4
Other, net	2.1	3.2	3.9	3.4	2.6
Errors and Omissions	-1.2	0.7	0.1	-1.0	-2.2
Malaysia (1989)					
Total Capital Inflows, net	-5.5	2.6	6.7	11.5	14.3
Direct Investment, net	1.7	4.4	5.4	8.5	7.7
Other, net	-7.0	-0.8	-1.2	3.5	6.2
Errors and Omissions	-0.2	-1.0	2.5	-0.5	0.4
Philippines (1990)					
Total Capital Inflows, net	3.5	6.0	6.2	5.1	6.6
Direct Investment, net	1.9	1.2	1.2	0.4	1.4
Other, net	0.5	3.5	5.3	5.7	4.7
Errors and Omissions	1.1	1.3	-0.3	-1.0	0.5
Thailand (1988)					
Total Capital Inflows, net	1.9	7.1	10.9	13.1	13.4
Direct Investment, net	0.5	1.8	2.5	2.9	2.0
Other, net	0.4	4.6	7.1	8.4	10.9
Errors and Omissions	1.0	0.7	1.3	1.8	0.5
Korea (1986)					
Total Capital Inflows, net	1.7	-4.6	-6.4	-2.8	-0.9
Direct Investment, net	0.2	0.3	0.3	0.4	0.2
Other, net	2.6	-4.4	-7.1	-2.8	-1.4
Errors and Omissions	-1.0	-0.6	1.0	-0.3	0.3
Singapore (1990)					
Total Capital Inflows, net	1.5	9.1	0.5	4.8	10.1
Direct Investment, net	10.5	11.0	10.5	12.3	11.0
Other, net	-7.7	1.7	-8.3	-0.9	-6.2
Errors and Omissions	-1.3	-3.6	-1.7	-6.6	-7.1
Taiwan (1986)					
Total Capital Inflows, net	-4.7	9.4	10.0	-9.4	-8.3
Direct Investment, net	0.3	-0.3	0.0	-2.6	-3.6
Other, net	-5.1	9.9	10.3	-6.8	-4.6
Errors and Omissions	0.1	0.2	-0.3	-0.1	-0.0

*First year of episode noted in parentheses next to country name.

Note: Positive values imply capital inflows

Source: Glick, R. and R. Moreno (1994)

Table 5
Contributions to Monetary Base Growth

	Average of Two Prior Years	Year of Capital Inflow Episode ^a			
		0	1	2	3
Indonesia (1990)					
Monetary Base	10.8	16.3	3.3	19.6	-
Foreign Reserves ^b	-3.0	58.1	62.3	66.0	-
Domestic Credit ^b	13.7	-41.8	-59.0	-55.4	-
Malaysia (1989)					
Monetary Base	10.0	28.5	23.7	19.1	12.2
Foreign Reserves ^b	11.0	28.6	36.0	18.6	76.4
Domestic Credit ^b	-0.8	-0.0	-12.4	0.5	-64.1
Philippines (1990)					
Monetary Base	27.6	17.7	20.1	13.0	18.9
Foreign Reserves ^b	18.6	-33.6	63.7	44.8	42.1
Domestic Credit ^b	9.0	51.3	-43.6	-31.8	-23.2
Thailand (1988)					
Monetary Base	16.3	14.9	-16.9	18.6	13.3
Foreign Reserves ^b	30.4	48.4	74.6	62.5	56.2
Domestic Credit ^b	-14.2	-33.6	-57.7	-43.9	-43.0
Korea (1986)					
Monetary Base	2.7	16.2	48.9	30.2	31.8
Foreign Reserves ^b	6.0	4.3	18.0	81.0	19.5
Domestic Credit ^b	-3.3	11.8	30.9	-50.8	12.3
Singapore (1990)					
Monetary Base	14.2	7.2	10.6	10.6	8.4
Foreign Reserves ^b	47.8	96.1	65.9	81.6	89.3
Domestic Credit ^b	-33.6	-88.9	-55.2	-71.0	-80.9
Taiwan (1986)					
Monetary Base	13.6	29.1	27.5	25.7	32.5
Foreign Reserves ^b	64.3	187.8	111.4	-4.6	-19.9
Domestic Credit ^b	-50.6	-158.8	-83.9	-30.4	52.4

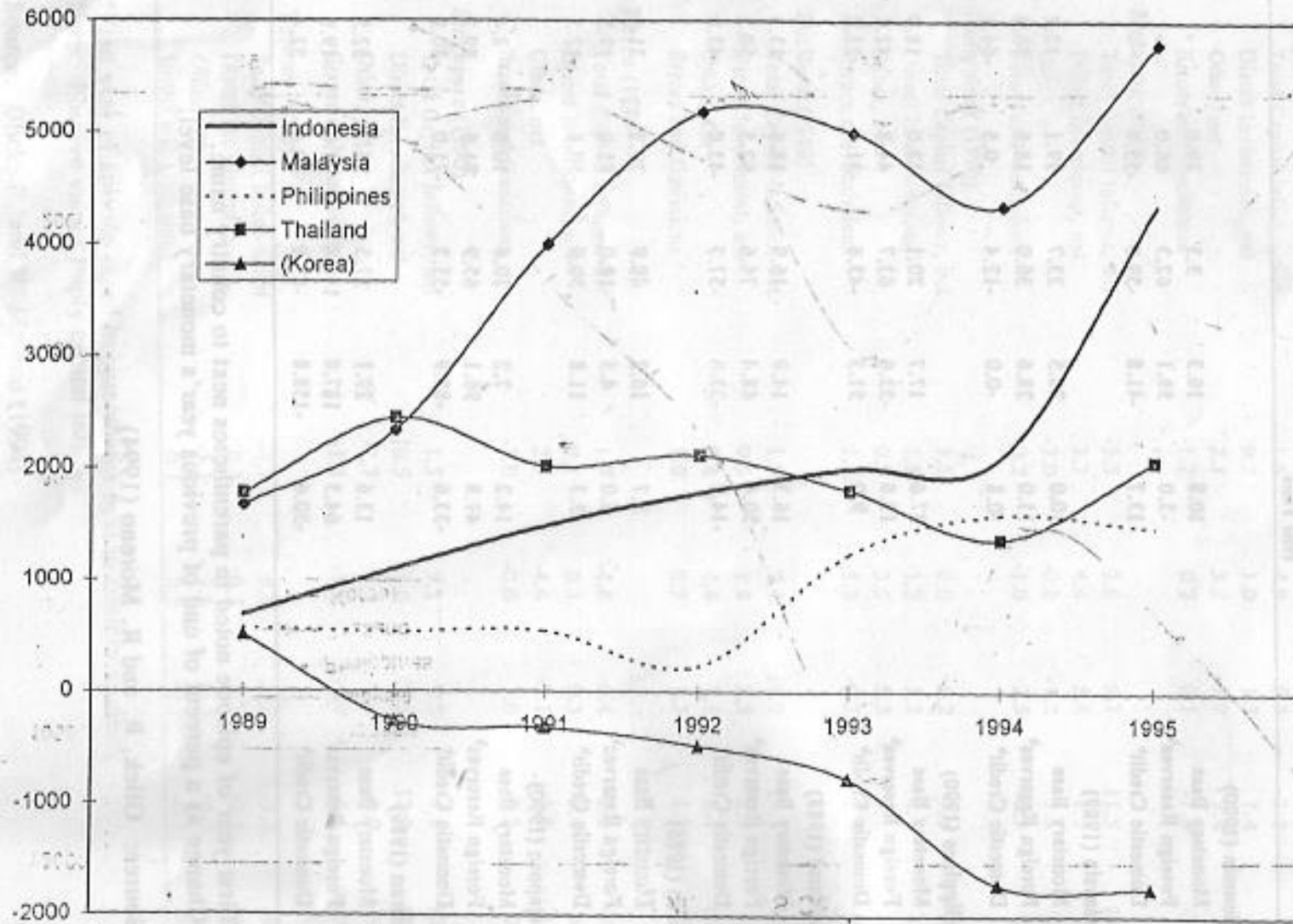
^aFirst year of episode noted in parentheses next to country name.

^bChange as a percent of end of previous year's monetary base level.

Source: Glick, R. and R. Moreno (1994)

Figure 1

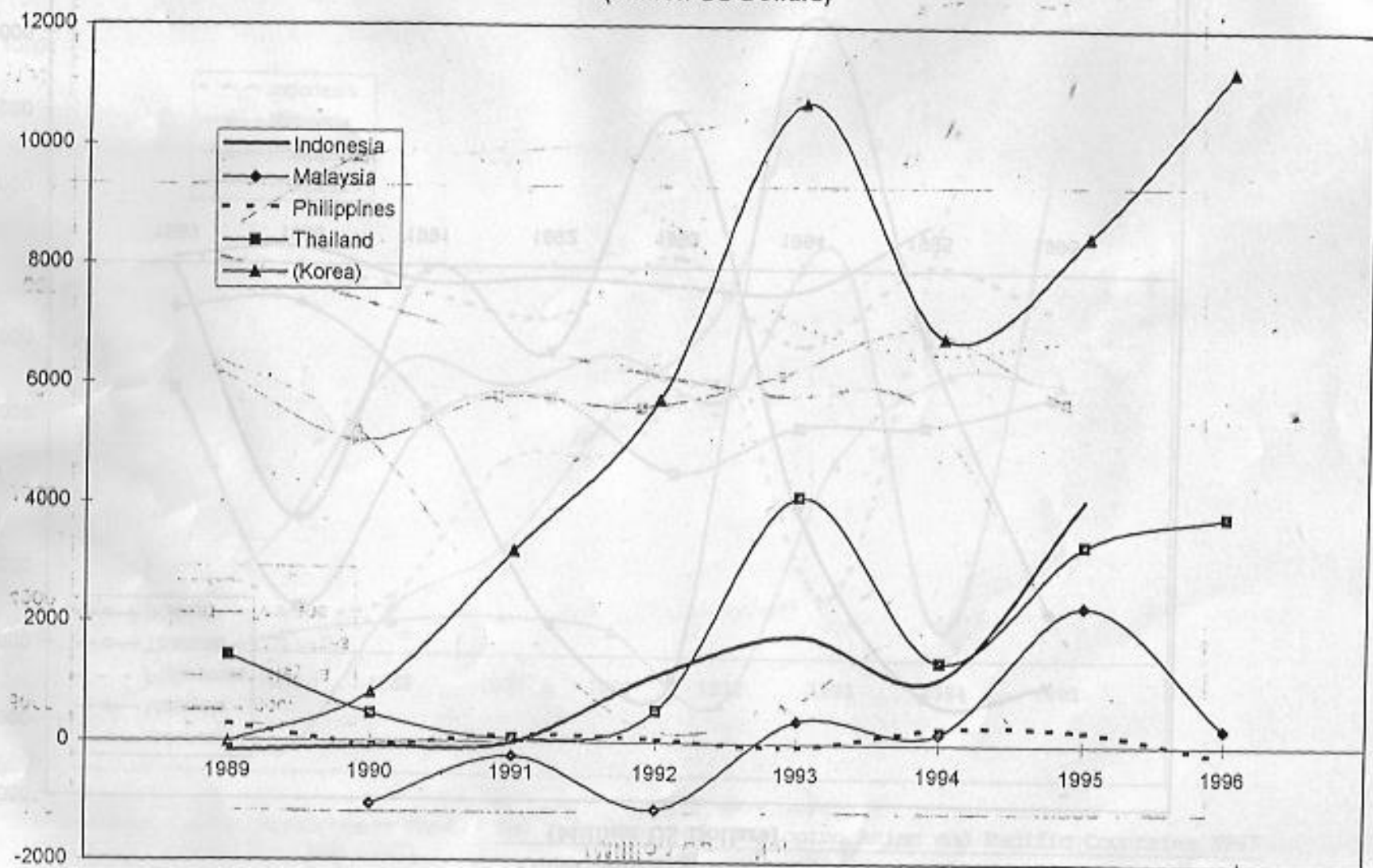
Foreign Direct Investment (Million US Dollars)



Source: Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries 1997
(Manila: ADB 1997)

Figure 2

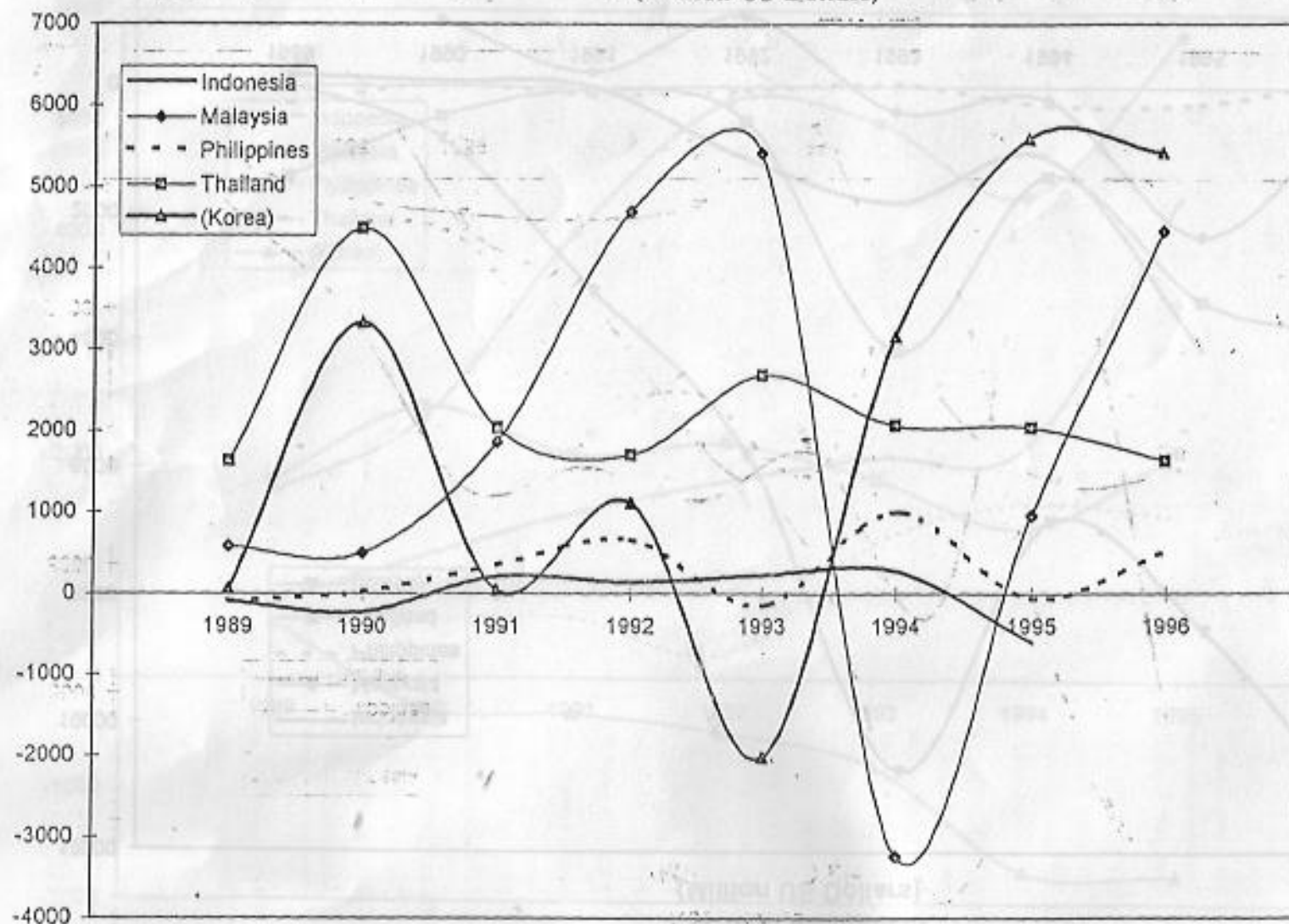
Portfolio Investment
(Million US Dollars)



Source: Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries 1997
(Manila: ADB 1997)

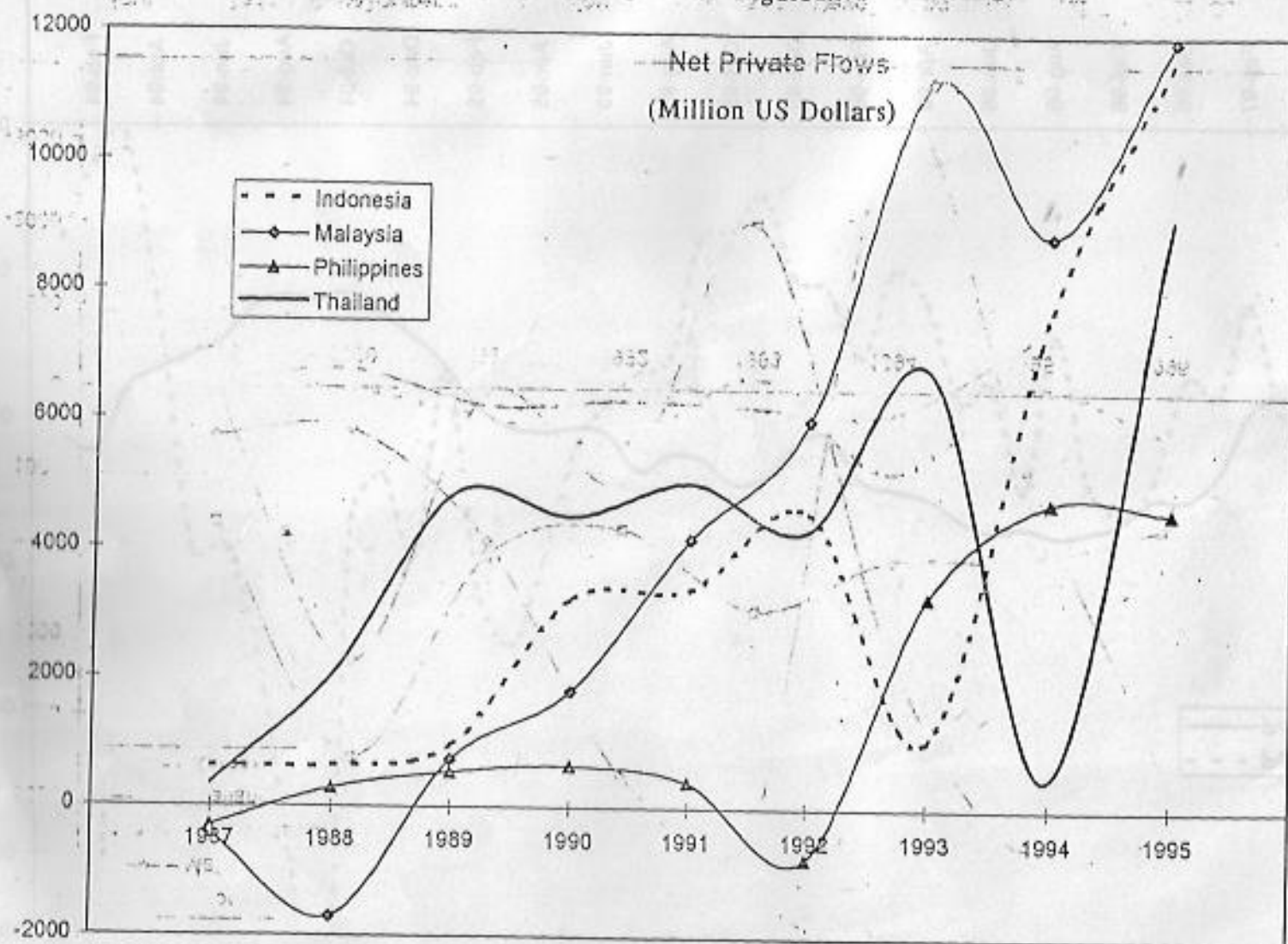
Figure 3

Other Short-Term Capital
(Million US Dollars)

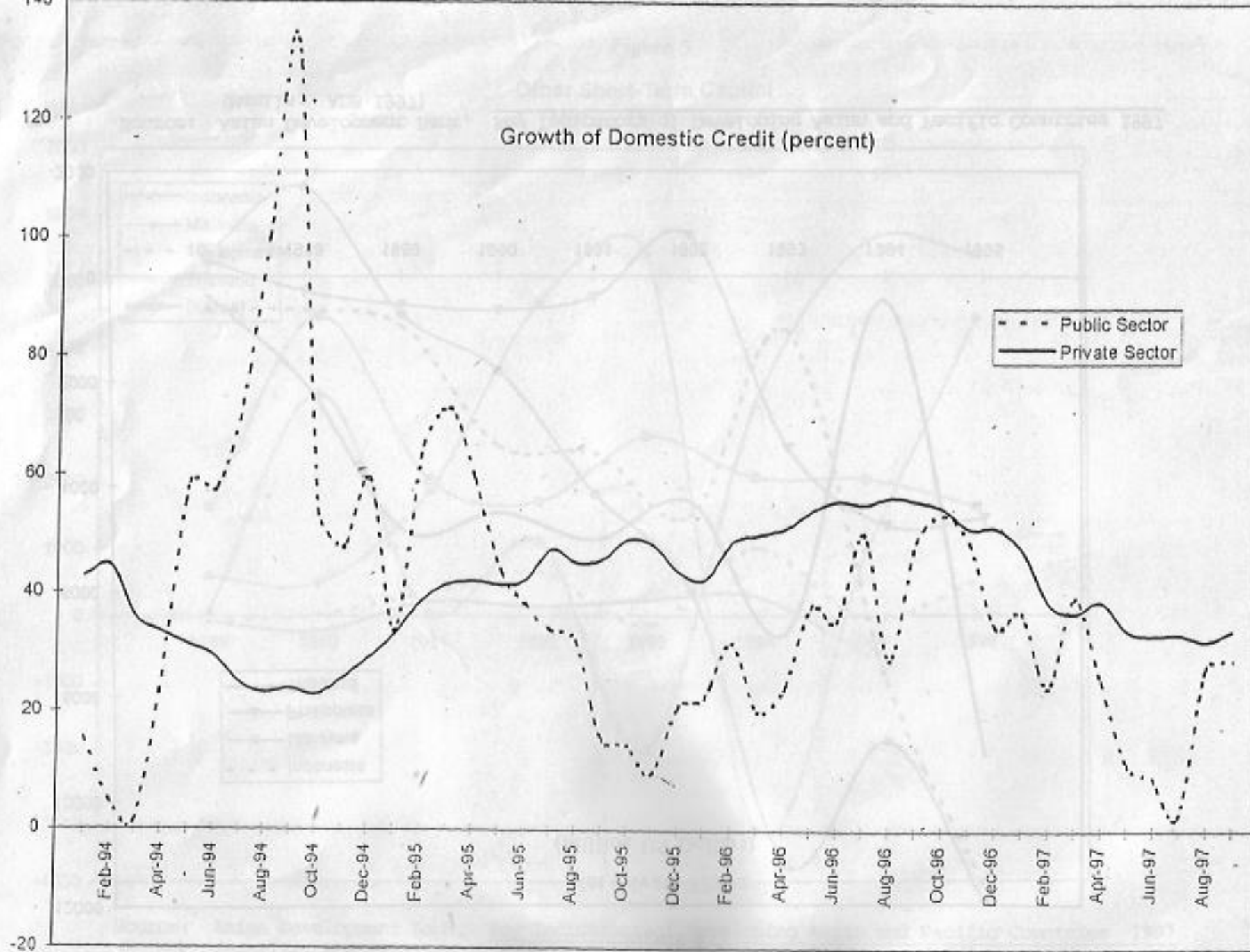


Source: Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries 1997
(Manila: ADB 1997)

Figure 4



Source: Asian Development Bank, Key Indicators of Developing Asian and Pacific Countries 1997
(Manila: ADB 1997)



Source: Bangko Sentral ng Pilipinas