Peterson Institute for International Economics

The Gated Globe:

Some Comments on *The Economist*'s Special Report on the World Economy

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Policy Limits on Globalization

- The seemingly inexorable “forward march of globalization” has halted since the 2008 financial crisis.
- Capital flows are down from the pre-crisis peaks.
- Trade has stopped growing faster than GDP.

Are Gates Harmful?

- On trade, it is hard to argue for gates.
- On finance, the case for gates is stronger.
- Report seems to waffle on finance:
  - "Policymakers … overestimate their ability to distinguish between good and bad capital."
  - Financial globalization was "too much of a good thing."

What Do Capital Flows Do?

- Allocate capital efficiently?
- <u>Net Flows</u>: Equalize returns on capital
  - Strongly rejected in data
- <u>Gross Flows</u>:
- Risk diversification
  - Partial support
- Technology transfer & competition
  - FDI

A Hierarchy of Capital?

- Foreign direct investment
- Portfolio equity
- Real estate
- Local-currency debt
  - Long term
  - Short term
- Foreign-currency debt
  - LT, ST

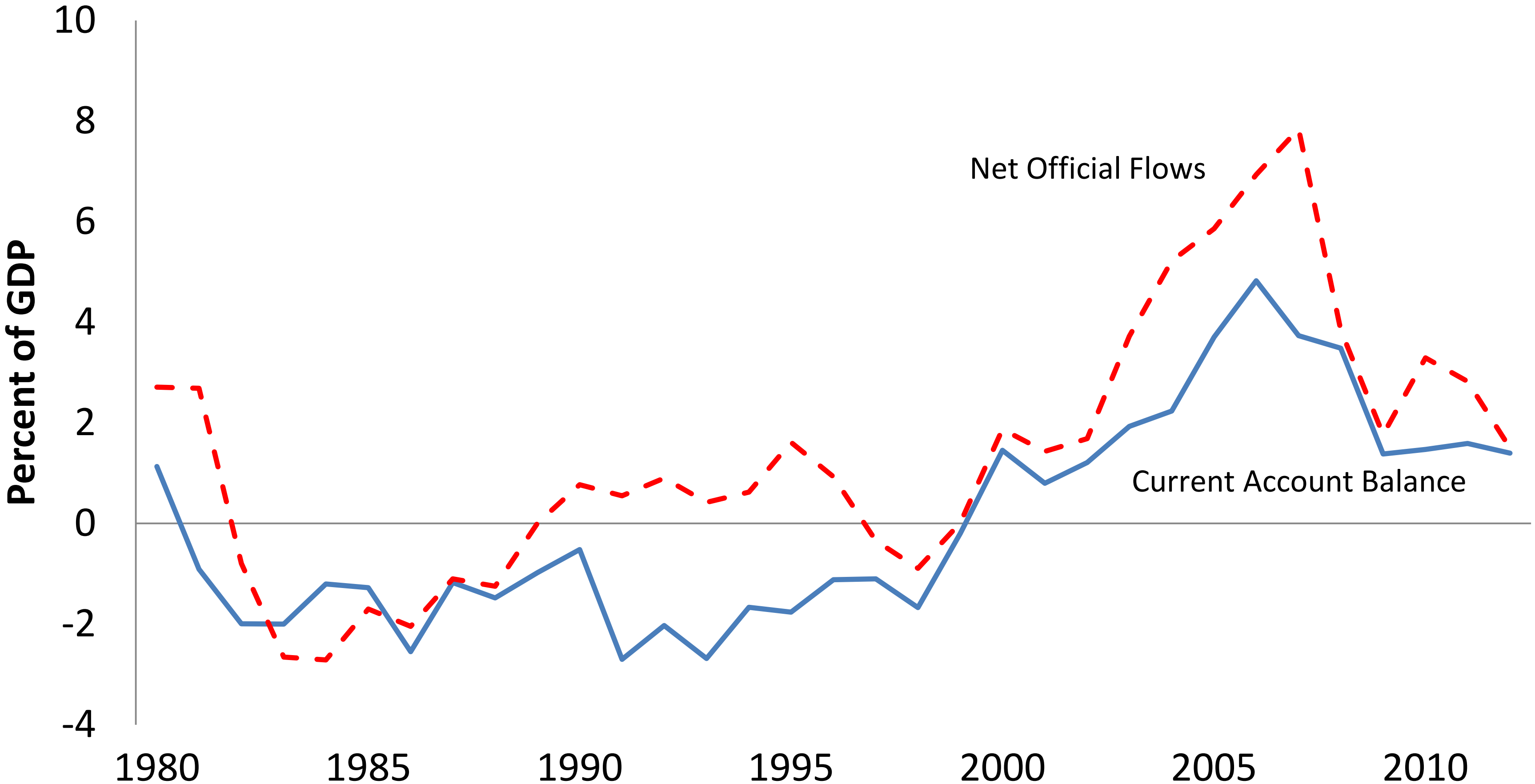
Automatic Stabilizers

- FDI, portfolio equity, and long-term local-currency debt are stabilizers:
  - Payments rise in good times and fall in bad times, including through exchange rate.
- Short-term local-currency debt has rollover risk.
- Foreign-currency debt is destabilizing.
- Both issuers and purchasers share in these benefits and costs.

“Foreign-exchange intervention is a zero-sum game.”

- “By artificially depressing interest rates in the recipient country, it also encourages excessive borrowing and bubbles there.”
- Puts QE-related capital flows in perspective.
- Uphill net flow of capital.

Emerging and Developing Economies Are Net Lenders



Note: Official flows do not include most sovereign wealth fund flows.
Source: IMF *World Economic Outlook* database.

"Foreign-exchange intervention is a zero-sum game."

- "By artificially depressing interest rates in the recipient country, it also encourages excessive borrowing and bubbles there."
- Puts QE-related capital flows in perspective.
- Uphill net flow of capital.
- The new mercantilism?
- Intervention deserves much more focus.

Conclusions

- Governments everywhere, but especially in emerging markets, are limiting and redirecting globalization.
  - But no outright reversal.
- Some of these limits are beneficial:
  - Reducing risky forms of capital
- Others are harmful:
  - Favoritism in trade
  - Mercantilist flows of official capital