

Do capitals flows destabilize emerging economies?

Martial Dupaigne * Marc Y. Robert †

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Preliminary version

Abstract

This paper provides an empirical analysis of the relationship between capital flows to emerging economies and their business cycles. We do so by characterizing the joint behavior of output growth rates and financial flows on a panel of 23 emerging economies between 1979 and 2001.

We investigate two issues. First, we look for asymmetries in the static relationship between capital flows and output growth to detect whether the interactions are the same during crises, recoveries and regular times. As a by-product, this exercise compares the crises of the 80s to the crises of the end of the 90s. Second, we consider the dynamic aspect of the relationship by running Granger-type causality tests. To identify the leading variable among the two, we use a mixed fixed-random estimator adapted to our heterogenous panel.

1 Introduction and related literature

Globalization has economic consequences on the financial sphere as well as in the real sphere. Transactions of physical goods (and to a lesser extent of services) have considerably risen for the last decade, as witnessed by the increase in the degree of openness of a large number of countries.¹ Many countries have increasingly been involved not only in the trade of goods but also in the trade of financial assets.² As a consequence, capital flows have

*GREMAQ, Université de Toulouse I, 21 allée de Brienne, F-31000 Toulouse, France. E-mail: martial.dupaigne@univ-tlse1.fr

†GREMAQ, Université de Toulouse I, 21 allée de Brienne, F-31000 Toulouse, France and UC Davis. E-mail: marc.robert@univ-tlse1.fr

¹Among others references, Kehoe [2002] and Rose [2002] document the changes in the degree of openness of countries members of the NAFTA and World Trade Organisation, respectively.

²Portfolio investment liabilities have increased on average more than twice as fast as Gross Domestic Product between periods 1979–1994 and 1994–2001 for the countries of our sample.