Delhi Business Review ✍ Vol. 1, No. 2, July - December 2000

MANAGEMENT OF GLOBAL FINANCIAL FLOWS

A CRITICAL STUDY

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GLOBALIZATION is now a fact, not an option. Globalization is most visible in the financial market. Today, there is phenomenal flow of financial capital across countries. Private capital flows for direct investment and portfolio investment to developing countries have grown rapidly from $ 25 billion in 1990 to $ 150 billion in 1997. In view of the recent trends across the global economy, the physical barrier of trade and commerce has broken and the global financial flow from one part of the world to other part is an inevitable phenomenon. The words pronounced in common parlance as globalization and liberalization, have profound impact on economies of developing countries. The effect of globlisation and liberalization so far debated till 1994 are benign. However, Mexican and East Asian economic crisis have revealed malign effects also. The time has come to ponder over the subject of financial management of economy. The emphasis on management of global financial flows is dire. Merely raising of fund and bringing financial flow to country's need is not a sufficient task but have also to see that the type of finance required to nation is appropriate or not. In many cases, the domestic companies borrowed from foreign market on a short–term basis to finance long term investment. The practice adopted by these companies would definitely be dangerous to them as well as to the nation. Proper planning and management of financial resources is an essential requirement of economy. The macroeconomics is a name of detailed planning, systematic management and efficient administration of financial flows. Planning in global financial flow is nothing but to match short-term finance for short term object and long term finance for long term application. Management of financial flows includes framing and adoption of government policies; establishments of trade standards, transparency in commerce, corporate governance, etc. The administration of global financial flows includes control policies, procedural aspects of de facto control on commercial activities, national security, etc.

Global Financial Flows

Finance is oxygen of trade and Commerce. The flow of oxygen gives more stimulation to body and growth of a human being and non-availability of such oxygen leads to death of human being. Likewise, non-availability of financial flows definitely gives embracing situation to trade and commerce. There are two types of financial flows; one is described as current flow of finance, which is meant for short-term objects or routine commercial activities and other for long term projects. All global economies have come to the threshold of globalization and liberalization. No country can have escape route; each has to perform trade and commerce either at global level or at regional trading blocks like ASEAN, NAFTA, and EU.

As far as financial flows or external borrowings are concerned, there may be different policies for each individual country. This is known as capital financing of funds. The sheer reason behind this is capital flows are a double-edged sword. When they flow in, they augment the investible resources and growth. When they move out, particularly suddenly and massively, they wreak havoc. The damage is in both social and economic terms. What is, therefore needed is a clear identification of

capital flows that can tend to be volatile and use appropriate measures to discourage such flows. Such flows are required to be regulated in the interest of balance of payment and growth of nation together.

Sources of Global Financial Flows

Sources of global financial flows may further be divided in two parts

(1) **On account of current Account :** Export, Grants, Subsidy etc.

(2) **On account of Capital Account :**
  (a) Private Capital Flows: -
  Foreign Direct Investment, Portfolio Investment Commercial Bank loan, Bonds, Non Bank creditors.
  (b) External Borrowings: -
  Official Borrowing, IMF loan, World Bank Loan, SDR.

From the following statistics, one can notice that global financial flows in the form of foreign direct investment in top ten developing countries is on an average not less than 72% of the global investments made by the investors community. Therefore, the recipient developing countries should try to get invested this type of funds in their countries for the long-term applications.

Table 1: FDI in Developing Countries

(Figures in $ billion)

COUNTRY	1991	COUNTRY	1994	COUNTRY	1997
Mexico	4.7	China	33.8	China	37.0
China	4.3	Mexico	11.0	Brazil	15.8
Malaysia	1.0	Malaysia	4.3	Mexico	8.1
Argentina	2.4	Peru	3.4	Indonesia	5.8
Thailand	2.0	Brazil	3.1	Polland	4.5
Venezuela	1.9	Argentina	3.1	Malaysia	4.1
Indonesia	1.5	Indonesia	2.1	Argentina	3.8
Hungary	1.5	Nigeria	1.9	Chile	3.5
Brazil	1.1	Polland	1.9	India	3.1
Turkey	0.8	Chile	1.8	Venezuela	2.9
Share of top ten in FDI To all developing countries(%)	74.2		76.1		72.3

It is clear from the above table that after first generation of reforms in the form of globalisation and liberalisation, India could get a meagre share of FDI. If proper financial resource planning is made, India would be able to share more proportion of global financial flows in the form of FDI for long term applications like infrastructure development, employment generation, poverty eradication, etc.

Selection of Global Financial Flows

Selection of appropriate financial flows from global financial resources is a vital process. Looking to the rapid growth of East Asian economies, once upon a time, it was debatable issue as to how the miracle changes took place in that A-5. (Indonesia, Malaysia, Philippines, Thailand, South Korea). Subsequently, mirage of development, growth, industrialisation etc. came to an end. During 1990 to 97 average annual GDP growth rate is tabulated as under as compared to that of 1981-90.

Table 2 : Average Annual GDP Growth of A-5

Country	1981-90	1990-97
Korea	9.1	7.16
Indonesia	5.4	7.39
Malaysia	6.0	8.53
Thailand	7.9	6.73
Philippines	1.7	3.13

Source : *The World Bank*

It is very clear from the table 2 placed as above that due to global financial flow to these developing countries, the average annual GDP Growth rate has improved in spite of recessionary situation in world economy except in case of Korea and Thailand. Financial flows tapped from outside for short term has been applied either for non productive activity like real estate or politically motivated projects without looking at its viability. Selection of inappropriate proportion of short-term debt to total debts and the kind of investment brought in by these countries put them in a bad shape on passage of time.

One should not blame an erratic behaviour of foreign investors in case where short-term fund has been used for long term applications and repayment of such borrowings becomes impossible at the time when it falls due.

The following table shows proportion of short term debt as proportion of total debt and reserves.

Table 3 : Short Term Debt as Proportion of Total Debt & Reserve

Mid'97	To Debt	To Reserve
Korea	67%	300%
Indonesia	24%	160%
Malaysia	39%	55%
Thailand	46%	107%
Philippines	19%	66%

From the above table it can be seen that the proportion of short-term debt to total debt was on higher side and the proportion of short-term debt to reserve was quite alarming. What is needed is a clear identification of capital inflows that can tend to be "volatile" and use appropriate measures to discourage such flows. It is such a discriminative approach that will ensure the benefits of capital mobility without harmful effect of volatility.

The volatility in case of commercial loan is very high as compared to portfolio investment and foreign direct investment (FDI). The Government policy should be framed in such a way that FDI and portfolio investment can be encouraged.
Table 4 shows the volatility of private capital flow in 12 developing Countries.

Table 4 : Volatility of Private Capital Flow
(Developing Countries 1992-97)
(Measured by Co – efficient of variation)

Volatility of Type of Investment		**Country's Specific Volatility**		
		Country	FDI	Portfolio
FDI	35%	1. Argentina	36%	51%
Portfolio Investment	43%	2. Brazil	96%	46%
Equity	38%	3. Chile	71%	68%
Bonds	51%	4. China	38%	71%
Commercial Bank		5. Hungary	57%	125%
Loan	71%	6. Indonesia	52%	63%
		7. Korea	57%	47%
		8. Mexico	40%	122%
		9. Philippines	41%	131%
		10. Singapore	46%	101%
		11. Thailand	19%	52%
		12. Uruguay	33%	65%

It is evident from table 4 that volatility in case of Commercial Bank Loan is 71% and average 35% and 43% in case of FDI and Portfolio Investment respectively. The decision of attracting Global Financial Flows in terms of FDI and Portfolio Investment is more prudent than commercial bank loan. Today, a need arises to do exercise and examine Indian national policy and procedures to consider rational view. A high level of short-term debt makes a country vulnerable. The Government policy should be evolved to extinguish the position of poor liquidity and insolvency.

Economic Policy Implications

Global financial flows set in directions where it finds profit opportunities, safety and liquidity. Global financial flows provide impetus to economy and high rate of growth. To provide conducive market to global financial flow, country should frame its economic policies whereby foreign institutional investors can pour their monetary funds for mutual benefits. It does not mean that country has to open up its market and liberalise all procedures. The strong fundamentals of capital market, government policy, exchange rate stability, structural reforms, political stability, sustainable export growth, macroeconomic adjustments can administer global financial flows in a favourable manner. Country should not bridge the gap of current account deficit (CAD) by way of capital financial flows. In Mexican and East-Asian economy, CAD was 5% of GDP. Under such circumstances, temporary shield was provided by capital financial flows in these countries without bringing it to the notice of the nation and industry. In such circumstances, many companies could not realise the effect thereof until economic crisis exploded and many became bankrupt.

Economic policy is a powerful instrument to regulate the financial flows, trade and commerce as a whole. Imposition of stringent control will not serve the object. The aim of policy maker should be

to curb speculative and destabilising flows and maintain minimal distortion of stock of productive capital. The policy should not be framed in such a way to disrupt or dislocate genuine trade related activities.

The present position of India with regard to export import business can be tabulated as under.

Table 5: Indicators of Indian Economy

(As % of GDP)

	1991-92	**1992-93**	**1993-94**	**1994-95**	**1995-96**	**1996-97**	**1997-98**
EXPORTS	6.7	7.1	8.1	8.1	8.9	8.6	8.3
IMPORTS	7.7	9.4	9.6	10.9	12.0	12.3	12.2
Trade Balance	-1.0	-2.2	-1.5	-2.7	-3.1	-3.7	-3.9
External Debt	37.7	36.6	33.1	30.1	26.3	23.8	23.8

Source : *Economic Survey 1998-99.*

Foreign exchange reserve of Reserve Bank of India as on 4/6/99 was USD 30.6 billion, which could finance about 9 months', Import Bill. And as a proportion of GDP, CAD turns out to be 1.7% in 1997-98. The economic policies should be envisaged in such a way, which can protect-domestic industries, which are to be considered as infant and provide ground level platform to other industries to face global competition. In the process of policy framing, concept of national security should not be ignored. The dynamic "BOT (B=Built, O=Operate, T=Transfer) Concept" of China Government has to be appreciated in right perspective wherein the government allowed foreign investors to build bridge, dam, road etc, operate them for certain period and then in due course transfer the same to the government of China. This is one example of economic policy adopted by China to best utilise foreign funds for development of infrastructure in a country, which otherwise requires huge capital investment.

Challenges Ahead

Management of global financial flows is a great challenge. "**Globalization refers to the growing economic interdependencies of countries through the increasing volume and variety of cross-boarder transactions in goods and services and of international capital flows, and also through the rapid and widespread diffusion of technology."** (IMF 1997 P.45)

The problems of management of global financial flows are (i) acceleration of export growth (ii) stability of exchange rate (iii) appropriate utilisation of financial flows e.g. external borrowing applied to real estate was 25% to 40% in Indonesia, Malaysia and Thailand and 15 to 25% in case of Korea and Philippines, which led them to non-productive activity and negative capital output ratio. In case of "India 1998 Resurgent Bond" has been issued for infrastructure development however so far nothing has been declared about their utilisation, (iv) increment in CAD (v) internal financial resource mobilisation and restructuring. (vi) political risk (vii) corruption risk (viii) well-regulated financial system (ix) corporate governance and disclosure (x) integrated data information system. In case of Mexican economic crisis, due to poor information system, entire economy exploded and created havoc. (xi) management of domestic savings.

Conclusion

Global financial flows are not meant for charity. The object is to earn profit and ensure security of the amount invested. On the other hand our aim is to accelerate the economic growth, increment in employment, best utilisation of natural resources, improvement in living standard and life

expectancy together with education. To accomplish the target, country has to work hard, plan well, administer marvellously, manage elegantly and drive economy systematically. Otherwise country has to face economic slavery and overdependency on foreign investors. Improper management of global financial flows is due to flaws in economic policies. Country can not remain isolated from global economy and therefore should be prepared to digest global financial flows since second generation of reforms and structural changes started to comply with WTO Agreement. At this juncture, policy should sound the businessman and industrialist to compete the global economy. The time demands consolidation of business group and to do collaboration and or joint venture with foreign investors as a part of management of global financial flows.

It is concluded that management of global financial flows is a joint task of government as well as industry. One should not blame only government for mismanagement of global financial flows. It is true that majority part of this assignment is shouldered by government. However, industry should support government in fulfilling its uphill task in the overall interest of the nation.

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