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The Effects of Cross-Border Capital Flows: Generation and Distribution of Crisis Processes

COMMEMORATIVE MEDAL FOR YOUNG RESEARCHERS

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Dear colleagues!

In November 2012, I joined the ranks of young scholars who provided support and assistance in the organization of the International N. D. Kondratieff Foundation, the 8th International Kondratieff Conference and the 20th Kondratieff Readings, and I had the good fortune to become acquainted and to spend three unforgettable days with Prof. Carlota Perez, the laureate of N. D. Kondratieff silver medal for contributions to development of social science. This meeting has become very significant for me especially because it showed how really harmonious and happy could be a scholar who achieved the goals of research and obtained good results. Earlier when I was listening to the speech of Prof. Perez I could not even imagine that soon I would be able to experience such happiness.

I would like to thank the International Foundation N. D. Kondratieff for such a high appreciation of my research. It is very symbolic for me that awarding the medal in competition for young scientists coincides in time with three major events in Russian and world economic science, *i.e.* the 125th anniversary of N. D. Kondratieff, the 25th anniversary of The International N. D. Kondratieff Foundation, and the anniversary of the Executive Director of the International Kondratieff Foundation V. Bondarenko. This award is of great significance for my family, and I get it thanks to my dear parents – Valery Arkhipov and Tatyana Arkhipova. I wish to express my sincere gratitude and appreciation to my dear teachers and colleagues: my first teacher of economics N. Bobrova (International Lyceum of Informatics, Economics and Laws, Krasnogorsk), the lecturer of economic theory I. Kamusher (The College of Public Administration, Moscow), my supervisors Prof. S. Silvestrov and corresponding member of RAS M. Golovnin, The Lomonosov Moscow State University and the Center

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for Research in International Macroeconomics and Foreign Economic Relations (Institute of Economics, Russian Academy of Sciences, Moscow) and its head D. Ushkalova.

I would like to briefly present the key points of my research and summarize its main results.

The study submitted to the competition consists of three papers (Arkhipova 2014a, 2014b, 2016a) and addresses the one general question – the development of the financial instability hypothesis and the search for effective ways to reduce the probability of financial crises in the world financial system (WFS). In this regard the following research objectives have been set:

- to study the nature of the effects of cross-border capital flows during the financial globalization of the 1980s – 2016, to carry out its extended classification and identify its main characteristics;
- to identify and analyze in detail the financial effects that can be considered as internal destabilizers of the WFS;
- to explore the systemic relationships between regional financial bubbles which occurred during the period of the second ‘wave’ of financial globalization, to offer an author’s interpretation of the concept of global financial bubble, to show evidence for its existence in the WFS and research into the causes and consequences of its development;
- to determine the role and effectiveness of destabilizing cross-border capital flows effects in the emergence of world and national financial and economic crises for the period of the 1980s – 2016;
- to outline the possible ways of leveling the negative impact of financial effects.

The comprehensive and dynamic research contains a thorough analysis of actual financial risks and challenges for WFS. Due to the need to study the causes and outcomes of the global financial and economic crisis, growing level of uncertainty and volatility in global financial markets the interest in this topic of the research has been growing steadily in the 2010s. In addition, despite the ongoing global financial reforms since 2008 the negative effects of cross-border capital flows and financial crises have not been ‘tamed’ yet. In terms of Russian economy the destabilizing financial effects of MFS often become an external ‘shock’ and require special consideration and control.

The research is based on the principle of scientific continuity, *i.e.* the study relies on and complements the financial instability hypothesis, crisis theory and financial bubble concept developed by foreign and Russian scholars such as Hyman Minsky (1992), Graciela Kaminsky and co-authors (Kaminsky, Reinhart, and Vegh 2003), Carmen Reinhart and Kenneth Rogoff (2012), Andrey V. Anikin (2009), *etc.*

It should be emphasized that we used the integrated methodological approach to the problem of cross-border capital flows. In particular, we conducted statistic and econometric data processing and analysis using the dataset provided by international financial organizations and institutions (*e.g.*, International Monetary Fund, Bank for International Settlements, World Bank, The World Federation of Exchanges, *etc.*) and national authorities of such countries as Russia, Japan, Scandinavian countries and Latin America, the USA, *etc.*, and also drew a comparison between different financial effects as a part of research.

The main findings of research on the effects of cross-border capital flows are summarized in the table below.

Table. The key features of the effects of cross-border capital flows, the 1980s–2016

The name of effect	Time			Area	Movement	Quality
	Background	Duration	Stage of WFS development			
Spillover effect № 1	Permanent duration		Before and after the 1980s	Inter-level: financial markets, trade	Primary Continuous	Positive / negative expected
Spillover effect № 2	Permanent duration			Inter-level: financial markets → real sector of economy	Primary Continuous	Positive / negative expected
Spillover effect № 3	Moment t-1 (the emergence of financial 'shock')	Lagged chain transmission		Local (a group of countries, a region): financial and economic	Secondary Discontinuous	Negative expected
'Contagion' effect	Moment t-1 (the emergence of financial 'shock')	Immediate chain transmission	Since the 1980s	Inter-level: financial and economic	Secondary Discontinuous Types of the effect: wave contagion, monsoon contagion, inter-agent, inter-market	Negative sudden
Financial bubble effect	15–40 months ¹ (emergence and growth)	Sudden collapse	Before and after the 1980s Since the 1980s	Local (a country, a group of countries, a region): financial markets ↔ markets of real assets / Global: financial markets	Secondary Discontinuous	Negative sudden

¹ The interval is specified on the basis of Kindleberger and Aliber 2010.

'Sudden stop' effect	Moment t-1 (capital inflow)	Sharp interruption of capital inflow / drastic changes of financial flows direction	Before and after the 1980s	Local (a country, a group of countries, a region): financial and trade	Secondary Discontinuous Types of the effect: by groups of investment	Negative/neutral/sudden
Effect of financial reforms	The start of financial reforms	Reform and post-reform period	Before and after the 1980s	Inter-level	External for WFS Discontinuous	+/-/neutral/expected

Source: revised and enlarged by the author (Arkhipova 2014a, 2014b, 2016a).

According to the proposed classification of financial effects taking into account its spatio-temporal and qualitative characteristics one can distinguish the following types of analyzed phenomenon²:

1. Primary spillover effect №1 and spillover effect № 2 which are responsible for the viability of the world financial system, continuously remain valid and can be positive or negative depending on the subjective assessment of the countries and economic agents experiencing its activity.

2. Derived (secondary and subsequent) spillover effect № 3, 'contagion' effect, financial bubble effect and 'sudden stop' effect. This group of financial effects is characterized mostly by its negative character and ability to trigger the financial crises of various scales and types. Financial 'contagion' in a pure form and global financial bubble are referred to as the objects of systemic generation that can be observed from the period of the 1980s until present.

We also suggest the additional classification of financial 'contagion' and distinguish the following types: a-b) 'wave' contagion effect and 'monsoon' contagion effect, arising during the transmission of financial 'contagion' in the first case from some developed countries to other developed countries; and in the second case from developed countries to developing countries or from more financially developed countries to the less developed ones within the group of countries with developing and emerging markets; c) global intermarket effect associated with the 'contagion' between global financial markets of banking services, securities and financial derivatives; d) global inter-agent effect reflecting the transfer of current financial problems from one systemically important financial intermediaries to the others.

Thus, we propose a new approach to the interpretation of an economic 'monsoon' and 'sudden stop' through the expansion of its content and methods

² While formulating the definitions we used the following works: Kindleberger and Aliber 2010; Forbes and Rigobon 1999; Kaminsky, Reinhart, and Vegh 2003; Masson 1999; Medlen 2007.

of assessment, and through attribution these financial phenomena to some kind of financial effects.

3. Effect of financial reforms is external for the system and also includes the impact of financial sanctions regime for countries, regions and different economic agents. This financial effect can have a positive, negative or neutral impact on economy at all levels (global, regional, or national). It is observed during the lifespan of the WFS, but is presented globally mostly in the period from 2008 up to the present.

The next part of the study contains a comprehensive analysis of the relationship between financial bubbles in geographical, inter-market and temporal spaces, theoretical evidence for the existence of the global financial bubble (GFB) in the WFS since the 1980s, identification of the causes, features and consequences of this financial phenomenon. The special consideration is given to the 'chain' of financial bubbles occurred during the 1970s – 2016 in the USA, Latin America, European and Asian countries (Arkhipova 2014a, 2014b, 2016b).

It is shown that the GFB inherited a number of characteristics from a conventional financial 'bubble' such as disturbance of the supply-demand structure in the markets of financial and real assets, dependence on the collective mental and physical state of economic agents, mostly negative consequences for the economy and difficulty in identifying in the short-run (Kindleberger and Aliber 2010). By the way, the GFB also has distinctive features acquired during its evolution such as dynamism, existence of a single set of interconnecting bubble episodes in different subspaces, wide geographical scope and significance of the results.

The paper describes the formation and movement of the GFB under the influence of the effects of cross-border capital flows and concentration of financial resources at particular markets. For example, all negative financial effects exercise specific functions during the life cycle of each 'bubble' included in the GFB (Arkhipova 2014b, 2016b):

- spillover effect № 1 and the effect of financial reforms are responsible for the formation of the center of capital concentration and the emergence of a 'bubble';
- spillover effect № 2 contributes to the formation of the internal structure of a 'bubble', its growth and filling with financial inflows;
- spillover effect № 3, 'contagion' and 'sudden stop' effects begin to affect at or after the moment of 'bubble' collapse;
- finally, all these effects support the viability of GFB and allow it to 'move' within the system.

Thus, we provided a comparative analysis of the cross-border capital effects and determined the interaction between these processes. The detailed classification of financial effects is of theoretical value and also has a range of

practical applications. In particular the study revealed one of the most significant groups of causes of financial destabilization, increased level of crisis in the WFS and external 'shocks' for national economy. The research highlights the causal relationship between the effects of cross-border capital flows and the global systemic imbalances and financial crises of the 1980s – 2016 (including the global financial and economic crisis).

The main components of effective resistance to the derived negative financial effects are multi-level control, the systems of 'quick response' and regulation of cross-border capital flows. A special role belongs to the global reformer represented by the G-20, the international financial institutions and national bodies. The patterns of such initiatives at the global level include, for example, the establishment and functioning of the global infrastructure hub as well as the creating and development of green financial instruments.

Thank you so much.

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