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Capital Mobility and Economic Performance

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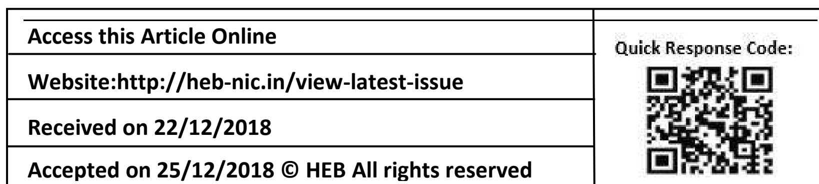
ABSTRACT:

According to the research private capital flows to developing countries mainly Foreign Direct Investment, Portfolio Investment and Debt. The purpose of the paper is to discuss about human capital approach and its relation with economic performance. The opening of domestic capital markets to foreigners is perhaps the most reviled aspect of this consensus.

The data of FDI, FPI and Debts are given for INDIA through graphs and it shows the external flow of capital. The paper also tells about the relation between human capital and economic growth.

Keywords: Capital mobility, Debts, FDI, FPI, Human capital.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1) INTRODUCTION

Capital principally refers to physical capital – durable goods used in the production process.When people refer to capital, they also may mean 'financial capital' or 'short-term capital'. This is not physical machines, but money and liquid assets.

Capital flows can involve:

- Foreign Direct Investment (FDI) – e.g. Nissan building a factory in England.
- Portfolio Flows – short-term capital, e.g. taking advantage of different interest rates and moving saving accounts to a different country
- Debts and Borrowings.

When the capital can be moved from one country to another, then the capital is known as mobile and the process of transferring the capital is known as capital mobility. When the capital is not easily mobile across countries then it is known as capital immobility.

2) THERE ARE MANY FACTORS THAT DETERMINE THE CAPITAL MOBILITY

Tariffs or taxes on the capital – the government may impose some taxes on the capital and higher taxes discourages capita flow. Restrictions on capital flows – the government may also impose some restrictions on the capital flow, e.g. the amount of capital that can be imported. Countries having a volatile exchange rate may discourage the inflow of capital.

There are some impacts of the capital mobility like if capital is mobile, then it will be easier to attract Foreign Direct Investment into the country. There could be better rate of return with improved capital mobility, it will be easier to move financial capital around to gain higher yields and interest rates. If capital is mobile it should reduce differences in real exchange rates. It could help equalise incomes between different countries.

Capital mobility will lead to growth of the economy by increase in the foreign exchange with the country and hence it is able to decrease the differences between the currencies by the appreciation of the home currencies.

i)FDI (Foreign Direct Investment)

Foreign direct investment (FDI) is an investment in a business by an investor from another country for which the foreign investor has control over the company purchased. Businesses that make foreign direct investments are often called multinational corporations (MNCs) or multinational enterprises (MNEs). An MNE may make a direct investment by creating a new foreign enterprise, which is called a green field investment, or by the acquisition of a foreign firm, either called an acquisition or brown field investment.

Advantage of FDI for the countries

- Access to markets: FDI can be an effective way for you to enter into a foreign market. Some countries may extremely limit foreign company access to their domestic markets. Acquiring or starting a business in the market is a means for you to gain access.
- Access to resources: FDI is also an effective way for you to acquire important natural resources, such as precious metals and fossil fuels. Oil companies, for example, often make tremendous FDIs to develop oil fields.
- Reduces cost of production: FDI is a means for you to reduce your cost of production if the labour market is cheaper and the regulations are less restrictive in the target foreign market. For example, it's

a well-known fact that the shoe and clothing industries have been able to drastically reduce their costs of production by moving operations to developing countries.

Figure 1

Foreign Direct Investment in India increased by 1898 USD Million in August of 2018. Foreign Direct Investment in India averaged 1322.17 USD Million from 1995 until 2018, reaching an all-time high of 8579 USD Million in August of 2017 and a record low of -1336 USD Million in November of 2017.

Human capital and the FDI

The FDI brings technological progress by introducing varieties capital goods, this process needs presence of sufficient level pf human capital to be implemented properly and cause some progress in the economy. So human capital plays a vital role in the working of FDI as a strong complementary effect between FDI and human capital. The contribution of FDI to economic growth be enhanced by its interaction with the level of human capital in the host country. So the productivity of the foreign should be higher than the domestic investment in the presence of human capital.

The interaction between FDI and human capital can be implemented through the following approximation:

$$G = C0 + C1FDI + C2FDI.H + C3H + C4Y0 + C6X$$

Where

G = rate of growth of the economy

FDI = Foreign direct investment

H = human capital stock

Y0 = initial GDP per capital

X = other variables which are included in the growth determination.

ii)Foreign Portfolio Investment

Foreign Portfolio Investment (FPI) is investment by non-residents in Indian securities including shares, government bonds, corporate bonds, convertible securities, infrastructure securities etc. The class of investors who make investment in these securities are known as Foreign Portfolio Investors. Investment by a

foreign portfolio investor cannot exceed 10 per cent of the paid up capital of the Indian company. All FPI taken together cannot acquire more than 24 per cent of the paid up capital of an Indian Company.

FPI gives access to bigger markets and international credit.

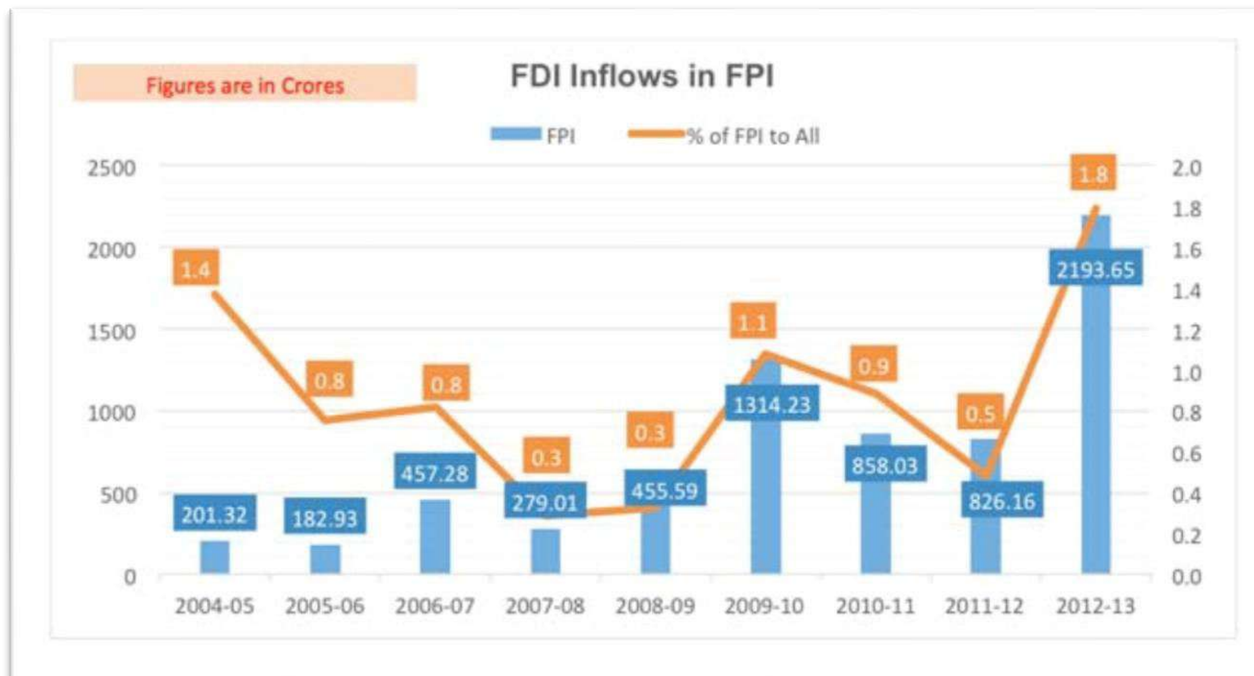

Figure 2

The above graph shows the FDI inflows in FPI from 2004 to 2013.

iii)DEBT

A duty or obligation to pay money, deliver goods, or render service under an express or implied agreement. One who owes, is a debtor or debitor; one to whom it is owed, is a debtee, creditor, or lender. Use of debt in an organization's financial structure creates financial leverage that can multiply yield on investment provided returns generated by debt exceed its cost. Because the interest paid on debt can be written off as an expense, debt is normally the cheapest type of long-term financing.

External commercial borrowing (ECBs) are loans in India made by non-resident lenders in foreign currency to Indian borrowers.Most of these loans are provided by foreign commercial banks and other institutions.ECBs include commercial bank loans, buyers' credit, suppliers' credit, securitised instruments such as floating rate notes and fixed rate bonds etc.

https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=40918

Table 1: External Debt - Outstanding and Variation							
(US$ billion)							
Component	Outstanding as at end-March			Absolute variation		Percentage variation	
	2015	2016 R	2017 P	Mar-16 over Mar-15	Mar-17 over Mar-16	Mar-16 over Mar-15	Mar-17 over Mar-16
1	2	3	4	5	6	7	8
1. Multilateral	52.4	54	54.5	1.6	0.5	3	0.9
2. Bilateral	21.7	22.5	23.2	0.7	0.7	3.4	3.1
3. IMF	5.5	5.6	5.4	0.1	-0.2	2.1	-3.5
4. Trade Credit	12.6	10.6	9.7	-2	-1	-15.6	-9
5.Commercial Borrowings	180.3	180.7	173.1	0.4	-7.7	0.2	-4.2
6. NRI Deposits	115.2	126.9	116.9	11.8	-10.1	10.2	-7.9
7. Rupee Debt	1.5	1.3	1.2	-0.2	-0.1	-15.1	-3.9
8. Short-term Debt	85.5	83.4	88	-2.1	4.6	-2.5	5.5
of which							
Short-termtrade credit	81.6	80	86.5	-1.6	6.5	-2	8.1
Total External Debt (1 to 8)	474.7	485	471.9	10.3	-13.1	2.2	-2.7
Memo Items							
A. Long-Term Debt	389.2	401.6	383.9	12.4	-17.7	3.2	-4.4
B. Short-Term Debt	85.5	83.4	88	-2.1	4.6	-2.5	5.5

(Dataset, 2017, RBI website)

The above table is taken for reference of the external debts borrowings in India.

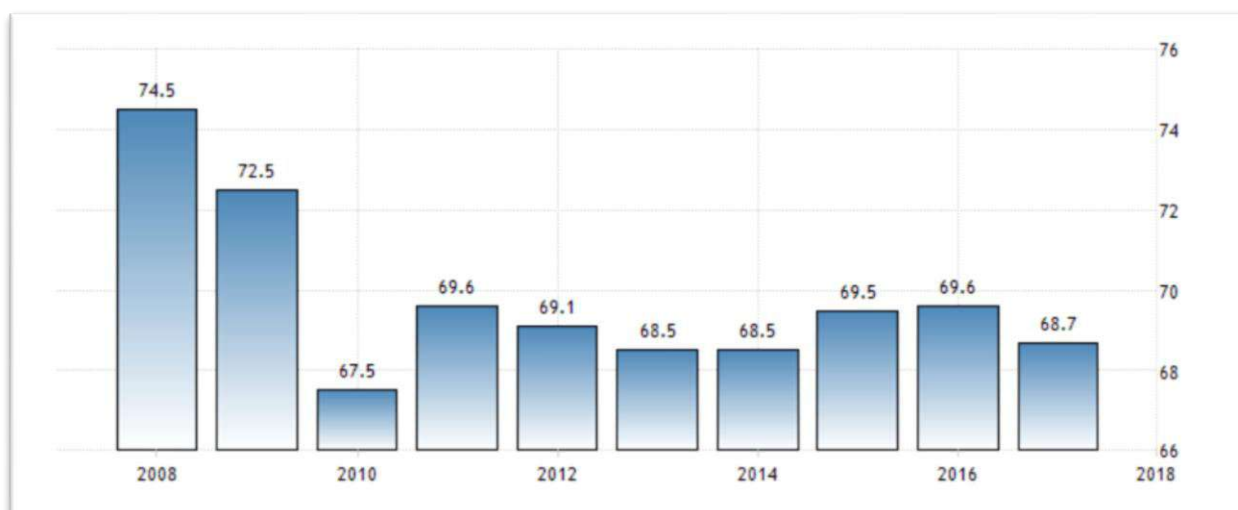

Figure 3

The above graph shows the external debt by India from the year 2008 to 2018.

3) CAPITAL MOBILITY AND ECONOMIC GROWTH

Capital account openness leads to growth through two main channels: increase in aggregate investment and an improvement in productivity and efficiency. Existing empirical evidence however, suggests that the link between capital account openness and economic growth is weak.

4) CONCLUSION

According to the research a country exercises his inflows and outflows through three main ways i.e. Foreign Direct Investment, Foreign Portfolio Investment,Debt.The results suggest that the FDI contribute to economic growth by increasing total capital accumulation in the host economy, explaining how the competition and the new imported quality increase the total investment by 1.5 and 2.3 times the increase in the flow of FDI.The sharp reduction of barriers to cross-border investments during the last few decades has led to a breath taking increase in international capital flows.

A greater of openness of the capital account can impact on economic performance through two alternative channels. The first, and most obvious one, is through it effect foreign savings, and through them, on aggregate investment. Countries with a more open capital account will have, in principle, the ability to finance a larger current account deficit, and thus increase the volume of foreign savings. If increases in foreign services are not reflected in a one-to-one decline in domestic savings, aggregate savings will be higher. This will allow for higher investment and, thus, faster growth. A plausible interpretation is that countries can only take advantage, in the net, of a greater mobility of capital once they have developed a somewhat advanced domestic financial market.

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