ECON-A4000 - Economics of Global Challenges
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Return method: through mycourses by the deadline

Problem Set 3: Question 5

The second part of lecture 9 had material on the development of international capital flows over time. I come back to this part in the last lecture as the material may not be self-contained enough for a self-study. This question builds on that lecture and asks: Does capital flow from richer to poorer countries?

1. China has enjoyed a period of rapid development over recent decades. Using data from FRED *(data)*, plot China's current account balance over the period 1998–2012, and describe how it has evolved since the late 1990s (Hint: search for 'total current account balance for China'). Make sure to highlight whether it is a CA surplus or deficit.

2. On the same graph, plot the current account balance of the US over the same time period, and compare it with China's current account balance (you can also find the data for the US at FRED by searching for 'total current account balance for United States').

3. What does your graph suggest about capital flows between richer and poorer countries? Read the 2007 article 'The paradox of capital' *(article)* by Eswar Prasad, Raghuram Rajan and Arvind Subramanian, who are IMF economists. Explain what is meant by 'capital flowing uphill' and whether or not it is a paradox.

4. Look at Figure 18.8 (from the textbook) and note that international capital flows (as measured by average absolute current account balances as a proportion of GDP) in the first decades of the twenty-first

century are similar to those of the late nineteenth century. Using the discussion of capital flows in this section and in the article from question 3, was capital 'flowing uphill' during Globalization I or Globalization II? Why, or why not?

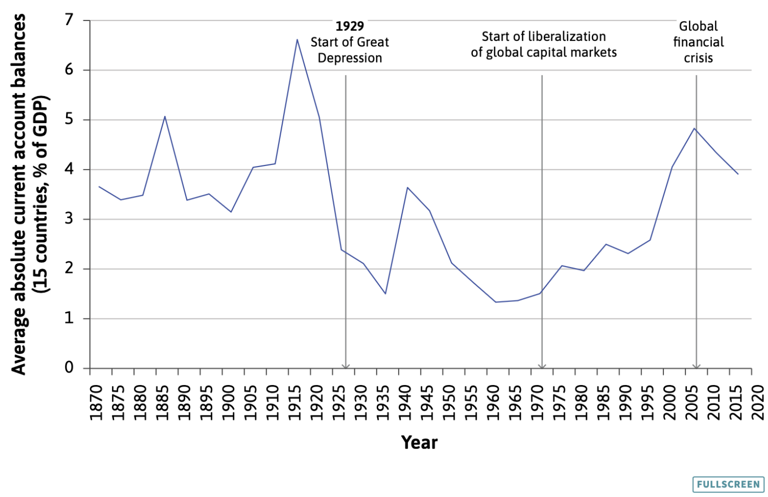

Figure 18.8 International capital flows (1870–2017).

View interactive graph

(1) Figure 2.2 from Maurice Obstfeld and Alan M. Taylor. 2005. *Global Capital Markets: Integration, Crisis, and Growth (Japan–US Center UFJ Bank Monographs on International Financial Markets)*. Cambridge: Cambridge University Press; (2) International Monetary Fund. 2020. *World Economic Outlook Database: October 2020*. Note: The data shown in the figure is the average absolute current account balance (as a percentage of GDP) for 15 countries in five-year blocks (from 1870–74 through to 2015–19). The countries in the sample are Argentina, Australia, Canada, Denmark, Finland, France, Germany, Italy, Japan, Netherlands, Norway, Spain, Sweden, UK, US.