

# Introduction

- 1 Debate over the role of private capital flows in international payments and appropriate government policies relating to them is a relatively recent phenomenon in the developing countries. Discussions of policy towards such flows in developing countries centred in the 1950s and 1960s upon the benefits and costs of foreign direct investment and the problems of “capital flight”. With the dramatic expansion of commercial bank lending to the developing countries in the 1970s and the subsequent debt crisis of the 1980s, attention shifted to analysis of sovereign debt, default, emergency lending, and possible “workout” schemes, with particular reference to the respective roles of government, banks and the international financial institutions. The difficulties encountered with financial liberalisation and the “opening” of external capital accounts in the Southern Cone of Latin America in the late 1970s generated a burst of research and discussion of necessary prerequisites or concomitants of a liberalised capital account and related issues of optimal sequencing (e.g. Diaz-Alejandro, 1985; Corbo and DeMelo, 1986; McKinnon, 1991). With the sharp increase in private international portfolio capital flows to developing countries in the 1990s, particularly to countries in Asia and Latin America, interest in the problems and possibilities they create began to accelerate, as did discussion of the appropriate external capital account regime for the recipient countries.
- 2 By the early 1990s several general analytical studies of these questions had already been undertaken (e.g. Williamson, 1991; Akyüz, 1992; Reisen and Fischer, 1993). In the past few years, stimulated by the Mexican crisis of late 1994 and early 1995, there has been an unprecedented degree of interest among policy makers on the problems created for developing countries by large and volatile international flows of private capital, larger for them than ever before, and appropriate policy responses. Both the IMF and the World Bank have directed a great deal of further attention, during this period, to the problem of volatile private capital flows and the management of capital surges (notably in IMF 1995b and 1995d; EDI, 1995; and Corbo and Hernandez, 1996). Not only has the IMF directed increased research attention to capital account issues in recent years but, in 1995, its Executive Board also authorised increased attention to them in its surveillance activities. Of course none of this recent experience or the analysis thereof has altered the prime need for macroeconomic policy to create a sound framework for private domestic savings and investment decisions, which remain at the core of successful long-term development.
- 3 This paper surveys the current debate on the new forms, and roles, of private capital flows to developing countries in the 1990s and appropriate national and international policy responses to the problems and possibilities they create. Section 2 describes the growth of these flows in the 1990s, their role in development and some of their effects in recipient countries. Section 3 addresses the question of alternative capital account policies for developing countries,

including the role of macroeconomic policies, controls and transaction taxes. In Section 4, the possibility of improved international arrangements is considered, including the provision of increased

liquidity, better procedures for orderly debt workouts, and clarified international regimes. Section 5 contains recommendations stemming from the previous analysis.