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Developing Countries' External Debt and International
Financial Integration

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Abstract: This paper assesses the dynamics of developing and emerging countries external debt and financial vulnerability. It is argued that, although current account positions do have a role in accumulating external liabilities, developing countries' vulnerability primarily lie in their increasing financial integration, which has resulted in the growth of their cross-border assets and liabilities. Rather than government falling into net indebtedness, which actually fell in many countries in recent years, developing countries are now more likely to be hit by financial instabilities originating from private credit and financial markets.

Key words: developing countries' debt, financial integration

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Introduction

According to standard neoclassical models, international borrowing by developing countries should be regarded positively for two main reasons.

Firstly, developing countries can finance development with foreign saving. By definition, these countries have lower capital stocks and lower saving rates, resulting in higher real interest rates and lower investment. Importing capital from richer countries, allows lucrative investment opportunities to be financed at lower interest rates and, provides a mutually beneficial arrangement: developing countries borrow from abroad to finance domestic investment, which will in turn provide the necessary resources to service their debt in the future.

The current account balance provides the link between foreign debt sustainability and economic development. Indeed, as Cooper and Sachs (1984) argue, a “country’s resources for external debt servicing each period can be measured by its trade surplus”. On a long-term perspective, the solvency requirement implies that the discounted value of future trade surpluses must be equal to the current foreign debt. A socially optimal borrowing strategy is to borrow until the marginal product of capital is equal to the world interest rate (Cooper and Sachs, 1984).

The second benefit of international borrowing is that of consumption smoothing. This comes from the “intertemporal approach to the current account”, which sees the balance of payments as determined by forward-looking investment and saving decisions (Obstfeld and Rogoff, 1995). Intertemporal utility out of consumption maximisation gives a result similar to the permanent income theory of consumption: consumption is a stable function of permanent national cash-flow, defined as the discounted sum of future total output minus investment and government expenditure (Sachs, 1982; Ghosh and Ostry, 1995). Current accounts are therefore used as a buffer against temporary shocks in national cash flows. For example a temporary negative shock in national output will not affect the country’s permanent cash flow, thus leaving current consumption unchanged. As a result the country borrows to smooth consumption, thus running a current account deficit.

The implications of these theories are particularly powerful. If developing countries borrow from abroad, they are either financing investment exploiting the lower cost of foreign capital, or they are trying to smooth consumption in anticipation of higher future incomes, due for example to a permanent productivity shock. In either case, current account imbalances and the resulting accumulation of foreign debt need not be a cause of concern. The corresponding policy view, known as the Lawson doctrine¹, maintained that, so long as current accounts deficits were originated in the private sector, the best policy would be to not intervene.

The balance of payment and currency crises that hit emerging and developing countries in the early 80's and then in the late 90's challenged this consensus. Authors began to question the relevance of the intertemporal approach to the current account and the associated Lawson doctrine. Reisen (1998, p. 25), for example, argues that "the intertemporal approach fails to predict the macroeconomic responses of most capital-flow recipient countries", and that assumptions such as rational expectations in the context of developing countries, which are experiencing structural changes, may not be fully justified.

Current account deficits therefore came under closer scrutiny. Indicators of sustainable current accounts were deemed sustainable if they were consistent with the solvency requirement, i.e. if they implied a long-run stable ratio of external liabilities to GDP² (Reisen, 1998; Milesi-Ferrett and Razin, 1998; Edwards, 2001). Evidence that persistent and sizeable current accounts deficits were historically rare and that their presence is associated with crises (Milesi-Ferrett and Razin, 1998; Edwards, 2001) also contributed to the less benign view on current account deficits. Furthermore, even if current accounts deficits were not the underlying causing the crisis, their existence and sharp reversal as a result of a sudden stop in net capital flows were theorised as the canonical crisis mechanics (Calvo, 1998).

Current account deficits, or lack thereof, remained a central research topic in the 2000's. An example of this, for the case of developing countries, is the literature on the capital flows "puzzle", the observation that in net terms capital flows "uphill" from developing countries

¹ From the name of Nigel Lawson, chancellor of the Exchequer in the late 80's, who firstly expressed this view.

² The rationale being that the net external demand for a country's liabilities should be consistent with the demand for net claims of those liabilities on future income flows by foreigners.

to advanced countries (Gourinchas and Jeanne, 2007; Prasad et al., 2007). As for the direct or indirect – through fuelling credit booms – relationship between current accounts and financial crises, Obstfeld (2012a, pp. 25-28) argues, the evidence on balance justifies policy monitoring on current accounts. At the same time, as Kose et al. (2003) document, financial openness, which was supposed to allow countries to fully exploit the consumption-smoothing function of current accounts, seems to be positively associated with *higher* consumption volatility, especially in lower-income countries.

Current accounts have been considered therefore a central issue for the issue of economic performance. Indeed, prominent IMF economists Blanchard and Milesi-Ferretti (2009) closely relate the development of global current account imbalances to the build-up and evolution of the global financial crisis, and suggest that their further reduction is a necessary condition to the post-crisis economic recovery.

While maintaining opposite opinions on the importance of current accounts for financial and economic stability, this view and the Lawson doctrine views share – sometimes implicitly – a common belief: the current account is the key driver of changes in foreign debt and foreign liabilities more in general. The focus therefore should be on *net* external liabilities, just as the current account focuses on *net* capital flows. This view has however been challenged by both empirical evidence and theoretical arguments.

Empirically, the trends of financial globalisation present a serious challenge for these views. As documented by path-breaking work of Lane and Milesi-Ferretti (2001) and subsequent related works (Lane and Milesi-Ferretti, 2003; 2007; 2008), the expansion of cross-border asset holdings over the past two decades, and in the 1990's decade in particular, has been unprecedented. While this trend has mostly occurred between advanced countries, emerging and developing economies have also experienced increasing degree of financial integration. This has given rise to a series of empirical regularities. Firstly, in general, gross cross-border holdings and financial flows are several orders of magnitude bigger than their corresponding net figures (Obstfeld, 2012b; Brunnermeier et al., 2012). Secondly, the accumulation of foreign assets has increased the importance of capital gains and losses on international investment positions (Lane and Milesi-Ferretti, 2007). Such “valuation effects”

have been subject of a vast literature, seeking to analyse their role as an alternative balance of payment adjustment mechanism (Gourinchas and Rey, 2005; Cavallo and Tille, 2006; Devereux and Sutherland, 2010). Thirdly, emerging and developing countries have accumulated more diversified liabilities – with more private debt and equity-like liabilities as opposed to the past concentration on public debt liabilities – as well as accumulating external assets, primarily in the form of foreign exchange reserves by central banks. Overall, their net foreign asset position seems to have improved in the decade preceding the global financial crisis (Lane and Milesi-Ferretti, 2007).

Alongside these empirical observations, “new” theoretical arguments were proposed in favour of focusing on gross rather than net flows and positions (Johnson, 2009; Borio and Disyatat, 2011; Broner et al., 2011; Bruno and Shin, 2013). Borio and Disyatat (2011) argue that, for the analysis of international financial relations, focusing on the current account is unjustified. Current accounts, by definition, only measure the transactions that relate to trade in goods and services and income transfers, while all the other asset transactions are excluded. In their view this arises out of confusion between saving – unspent income - and financing – a cash flow concept. Investment, like most economic activities, does not require saving but financing, which can be found domestically or internationally, in the latter case generating a cross-border money flow as a result of which an institution in the lending country will have a claim (a loan asset) on the borrower and the borrower will have a claim on the lender (a bank account credit, which can be transferred to other agents). As a result, current accounts are not necessarily tied to any specific gross flows nor any specific domestic activities and therefore it is wrong to assume that a current account surplus is “necessary” for reserves accumulation or that current account deficits are necessary to finance investment internationally.

These arguments inspired a new theoretical and empirical research into the dynamics and consequences of gross capital flows. For example, both gross inflows and outflows typically move pro-cyclically, and crises tend to involve sharp reductions in both (Broner et al., 2011). Sudden stops of gross flows, whether or not resulting in net sudden stops, may be very damaging to the economy (Cavallo et al., 2013).

The analytical emphasis on gross flows and cross-border holdings, along with the stylised facts of financial globalisation, suggest a different line of inquiry into developing and emerging countries external financing needs. Alongside traditional indicators, such as current accounts and trade balances, the evolution of developing and emerging countries external debts should be analysed in relation to their integration in the global financial system. Consequently, any assessment of the vulnerability of such external positions must take into account the characteristics of such integration, which may raise different issues than the common balance of payments vulnerabilities.

The rest of this paper will therefore proceed to analyse the foreign debt situation of developing countries in detail to understand its relation to financial integration. Section 1 presents a detailed analysis of developing countries external debt. Section 2 assesses the evolution of the “traditional” external vulnerabilities indicators, current accounts and trade. Section 3 will further discuss some features of financial integration in developing and emerging countries. Section 4 concludes.

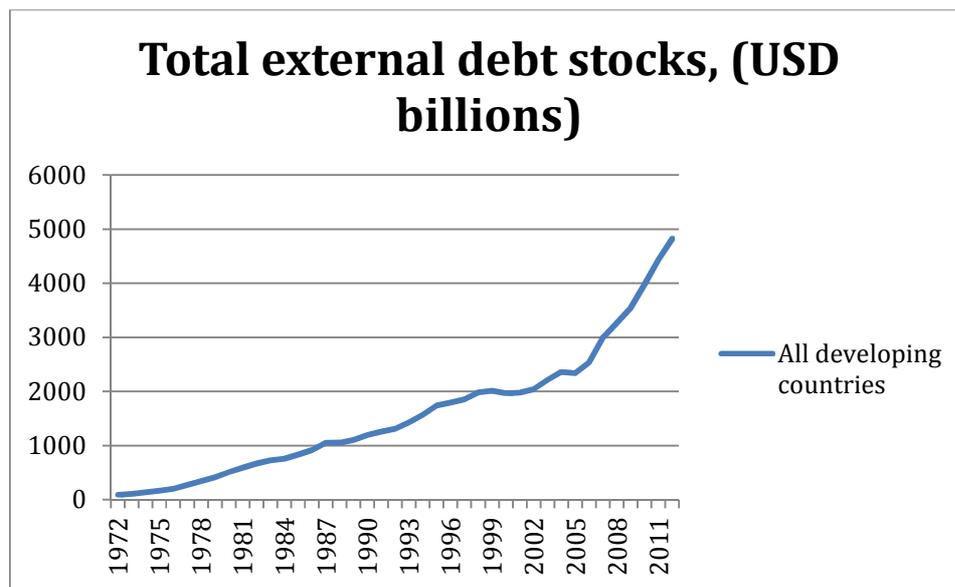
1 External debt

This section presents an overview of the features of the external debt of developing countries over the past decades.

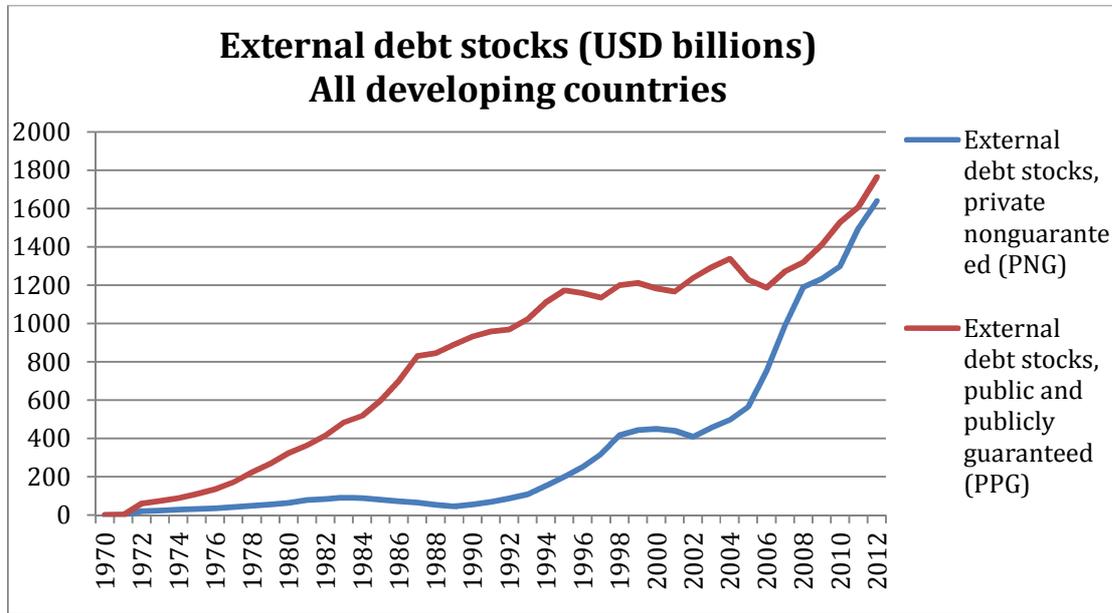
The standard understanding of external debt is based on current liabilities by residents to non-residents that necessitate payments of principal and/or interest in the future. External debt encompasses any liability that represents a claim on the resources of the resident's economy, and covers all types of debt instruments. External debt statistics are fully compatible to statistics from the System of National Accounts and the IMF's Balance of Payments Manual. Measurements do not include contingent liabilities. The data source used for external debt statistics is the World Bank's International Debt Statistics database unless stated otherwise.

1.1 All developing countries

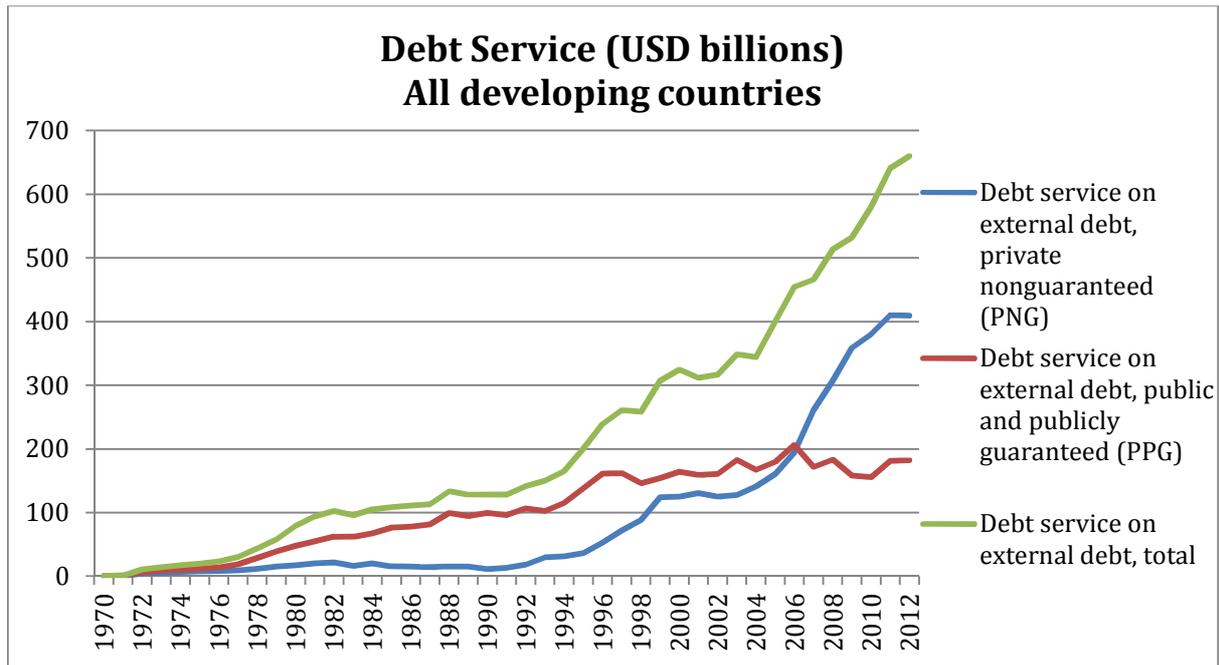
The external debt of developing countries has grown steadily since the 1970s. After the year 2000 the rate of growth increases, and debt is accumulated at a much faster rate. By 2012, developing countries owe just under \$5 trillion to non-residents.



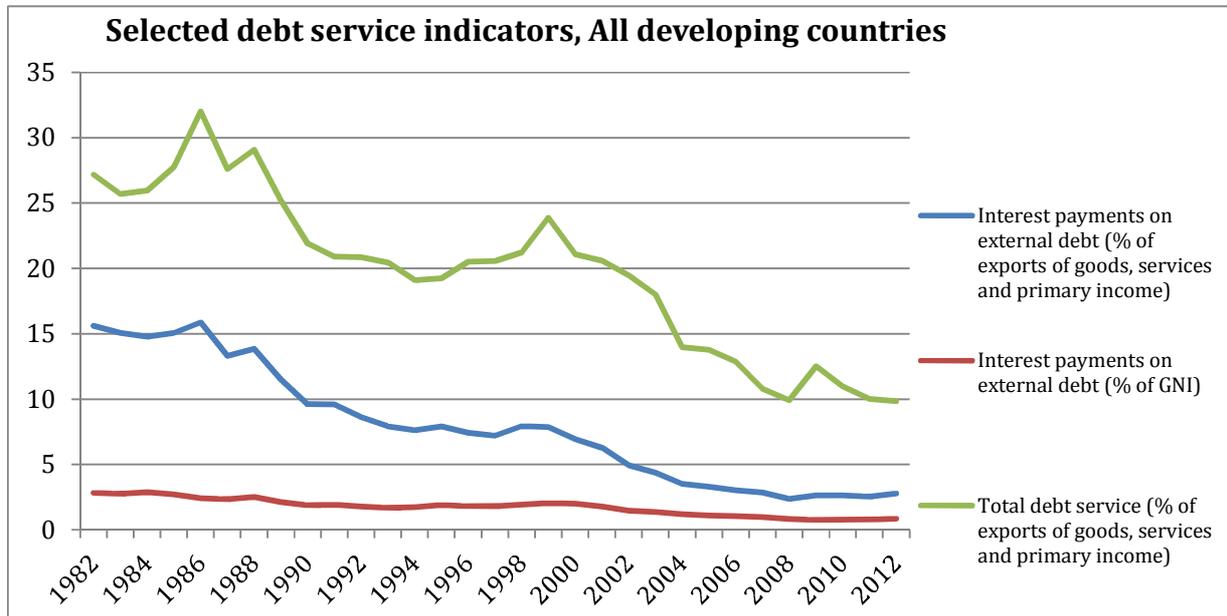
One feature of this growth in external debt has been the increased proportion of external borrowing undertaken by the private sector. During the 1970s and 1980s external debt accumulation in developing countries was mainly through the public sectors. It was not until the early 1990s that the private sectors of developing countries began to borrow abroad, gradually at first, and since the mid-2000s at a rapid pace. In 1989, the private sector of developing countries had debts that amounted to 5% of total external debts. By 2012 this has surpassed 35% of total external debts now owed by the private sector. It is worth pointing out that this is partially due to the substantial size of debt-financed FDI by corporations within emerging markets, and debt-financed merger and acquisition activities such as by Cemex which originated in Mexico, or Anglo-American corporation of South Africa. A significant source of private sector indebtedness in emerging markets seems to arise from the aspirant transformation of emerging market companies into multinational companies.

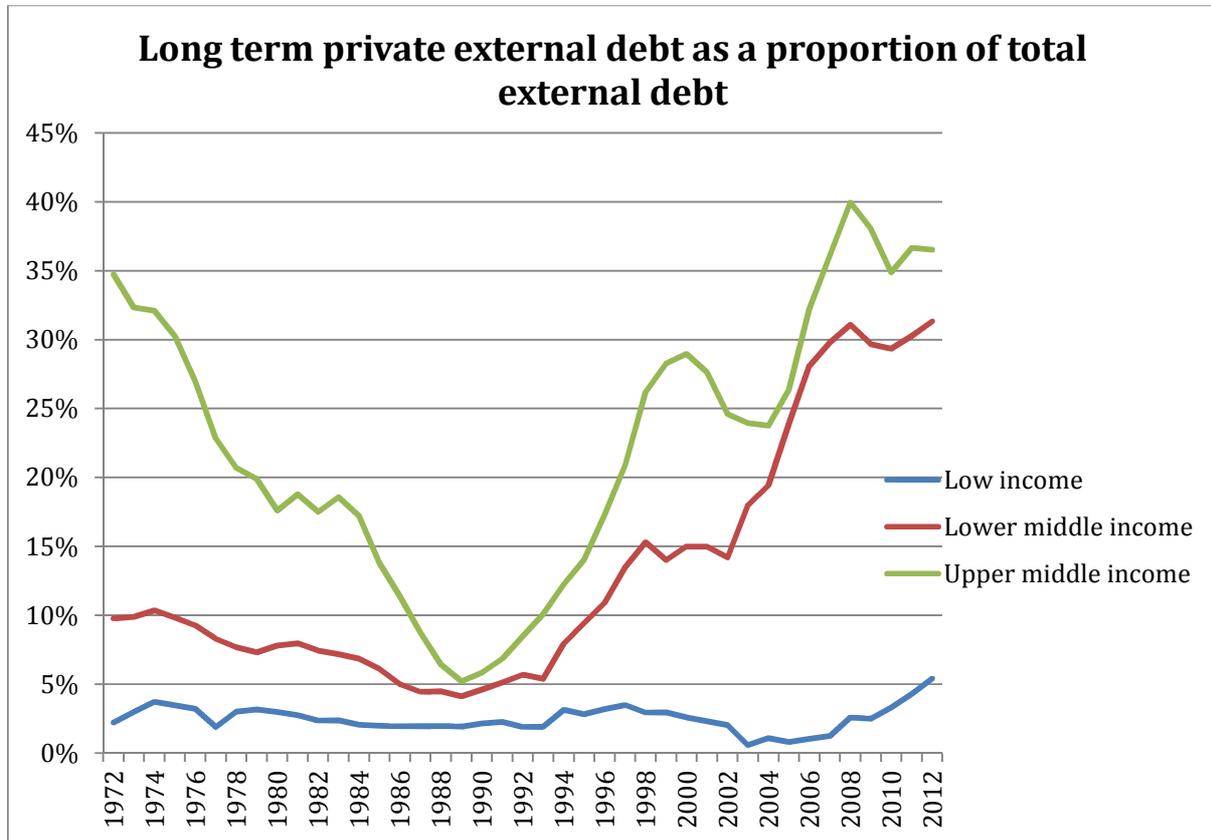


To draw out more concretely the changing structure of developing country's external debt and the flows of repayment arising out of those debts we can look at the debt service for all developing countries. The graph indicates that since 2007 the majority of debt servicing is for debts of the private sector.



However, many debt indicators of developing countries have on aggregate improved in the last three decades.

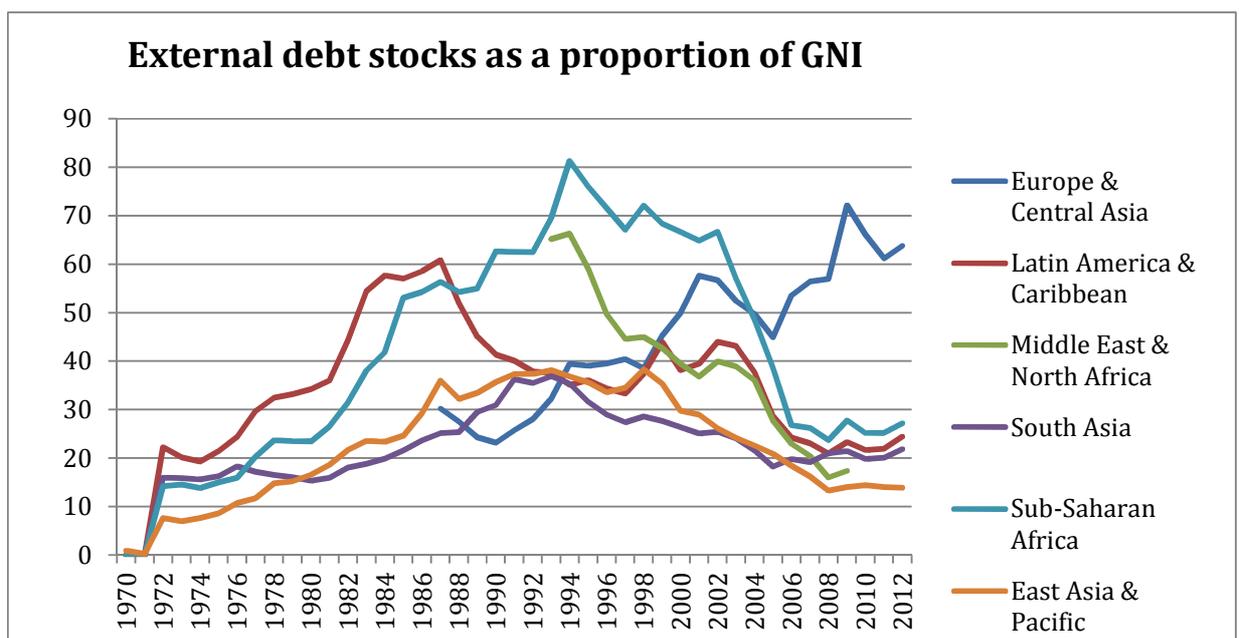
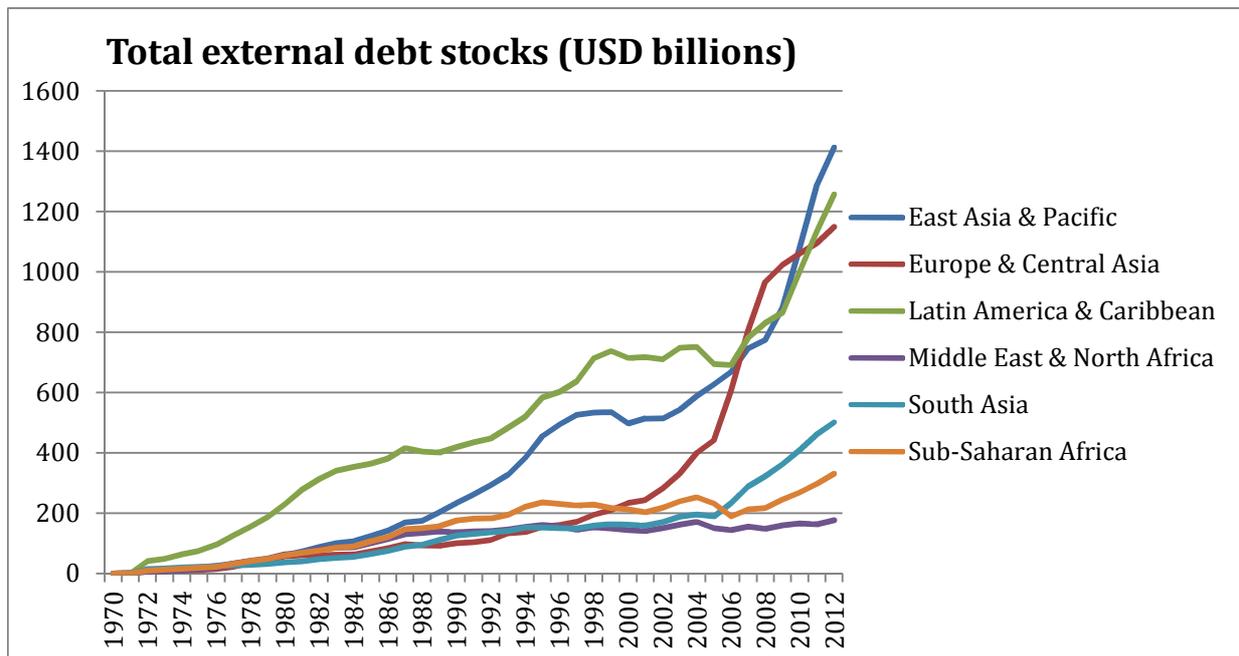




1.2 Regional disaggregation of external debt

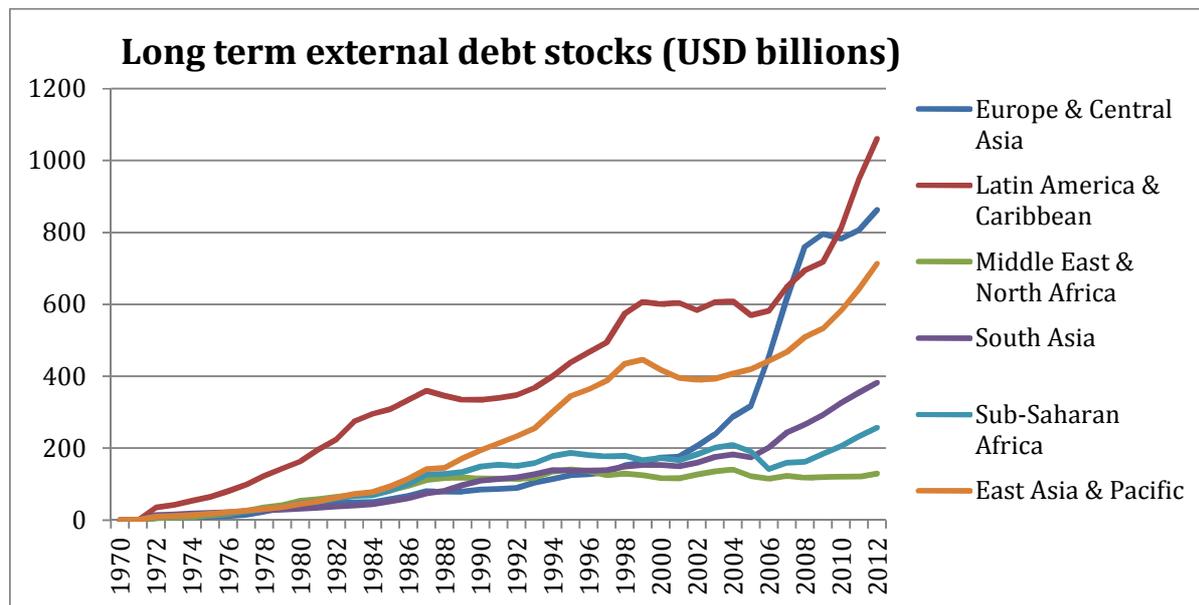
This section will explore the different regional dynamics. Historically, LAC had the largest external debt stocks; this has been rivalled in the past decade by the rise in external debt in ECA and EAP regions. Contrary to what might have been expected, post 2008 crisis external debt accumulation in all regions has continued apace, with the three largest debtor regions with external debts in excess of \$1 trillion. Sharp increases in external debt stocks are also noted for the SA and SSA regions since 2006 onwards. When looked at in relative terms, we can see that GNI grew at a faster pace than external debt stocks between the mid-1990s and mid-2000s, leading to a gradual decrease of external debt in relation to GNI in all regions bar ECA. Whereas previously each region had external debt stocks of much greater proportion

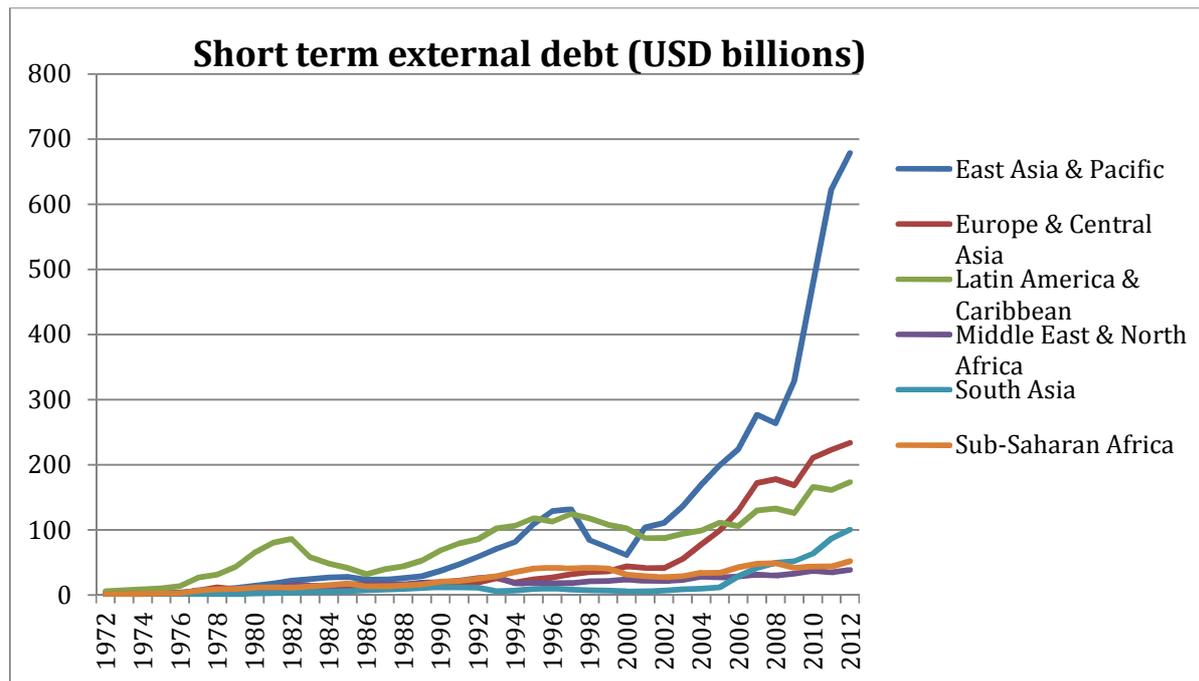
of their GNI, even if highly varied between the regions, since 2000 we can observe two things. The range of relative indebtedness has converged in all regions bar ECA and the level is much decreased. In 2012 the least relatively indebted region is EAP with 14% and the most is SSA with 25% of GNI, excluding ECA whose relative indebtedness has increased steadily since 1990. Since 2008 the relative indebtedness of the regions has been stable.



1.3 Short term and long term

In absolute numbers, the regions with the largest long term external debt stocks are LAC, ECA, EAP, all of which have seen their long term debt stocks grow rapidly within the last decade. From a lower starting point, SA and SSA have also seen fast accumulation of long term debt since 2006. The MENA region's long term external debt has remained roughly constant. Since the 1970s the two regions which were accumulating short term external debt were LAC and EAP, with the ECA region increasingly borrowing short term since 2002. Rapid accumulation of short term debts for the EAP region began in 2000, and rapidly grew since 2008.





1.4 Regional View

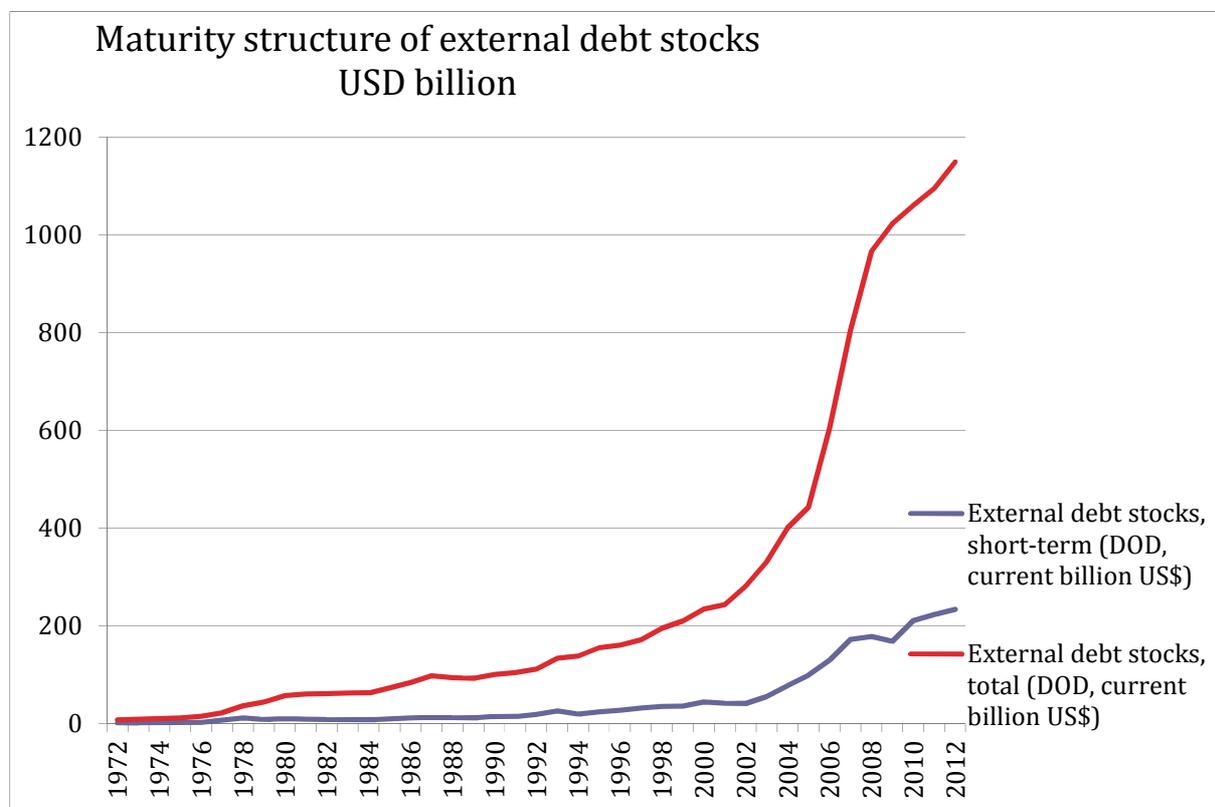
This section will look into each region in more depth. For each of the six regions we will look at the maturity structure, ownership structure and debt structure.

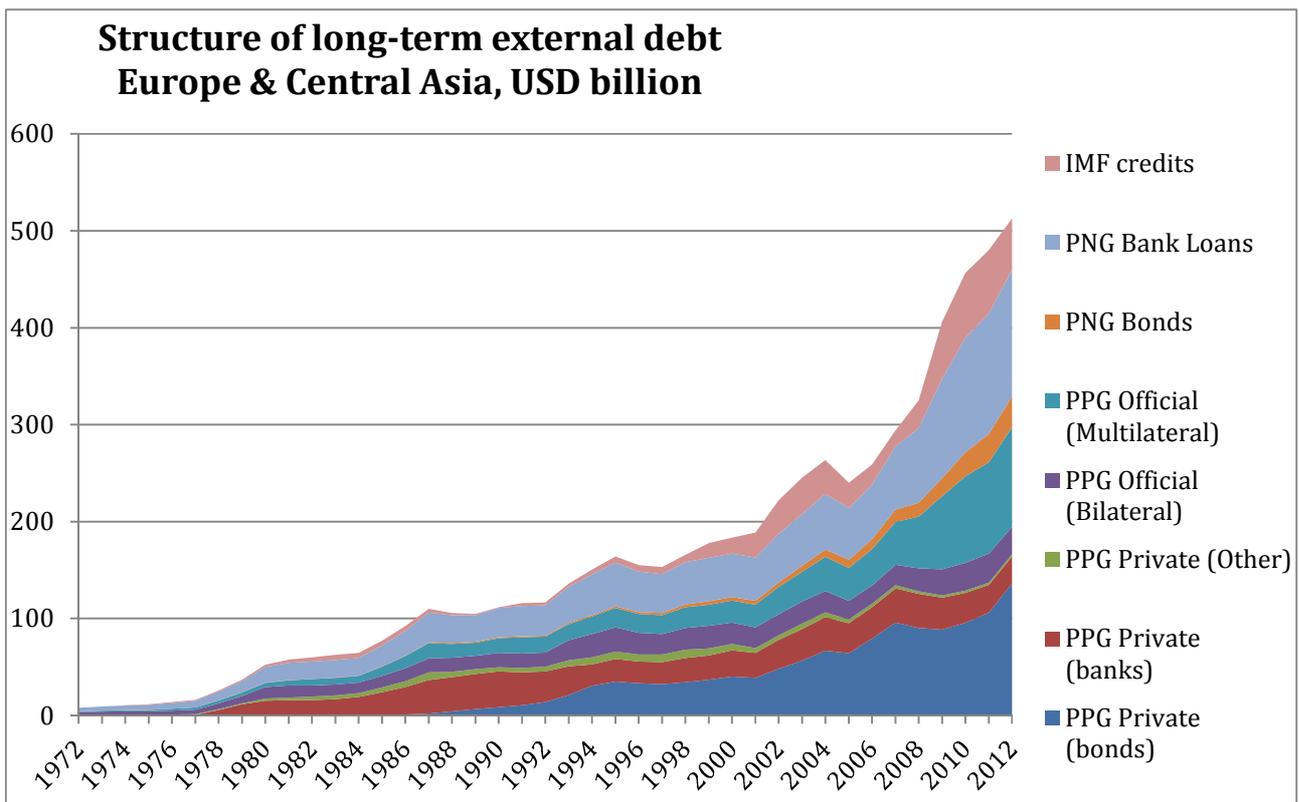
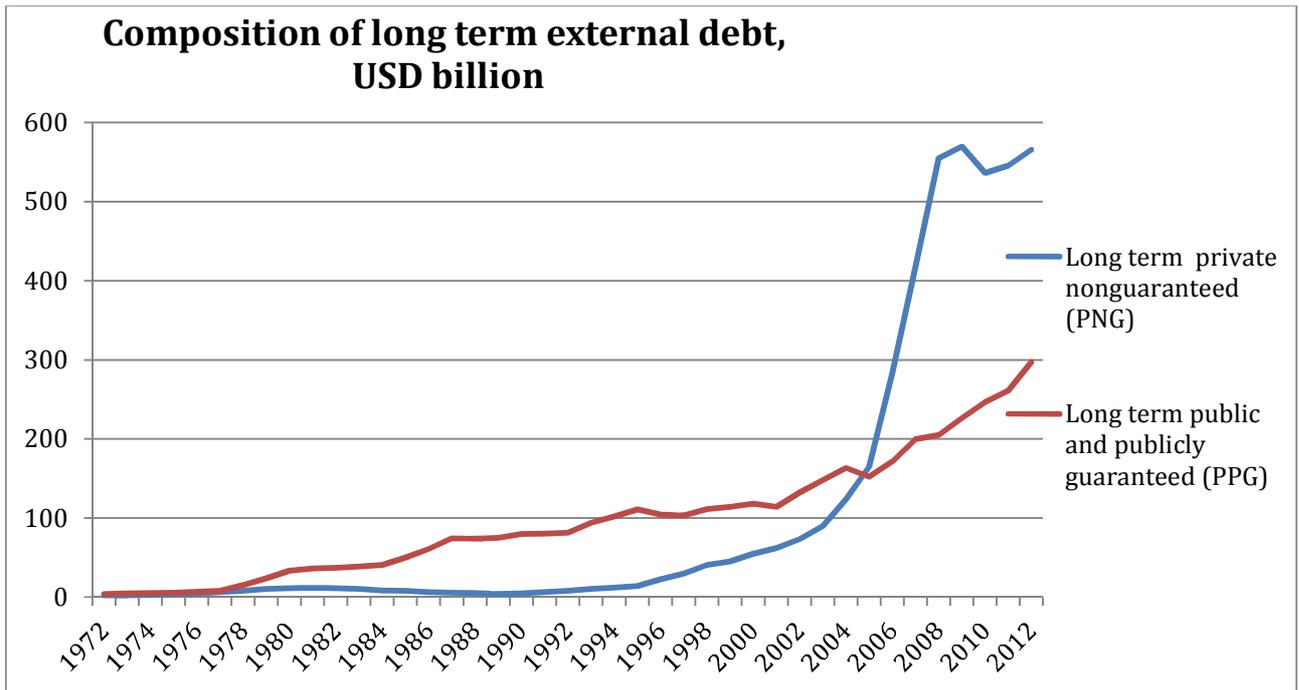
1.4.1 Europe and Central Asia³

There has been a steady increase in external debt in the region, which has exhibited a sharp rise from 2005 onwards. The vast majority of the debt is long term external debt, as the proportion of the total that is short term is less than a fifth. Historically long term external

³ Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Georgia, Hungary, Kazakhstan, Kosovo, Kyrgyz Republic, Macedonia, FYR, Moldova, Montenegro, Romania, Serbia, Tajikistan, Turkey, Turkmenistan, Ukraine and Uzbekistan.

debt was mainly owed by the public sector, i.e. from 1972 until 1996, and the private sector's external borrowing was negligible. Since 1996 it has risen, and by 2004 has surpassed the public sector's external borrowing reaching almost double its size by 2012. A more detailed breakdown of the structure and composition of external debt are provided. The largest components of external debt are PNG (private and non-guaranteed) bank loans, PPG (public and publicly guaranteed) bonds held by foreign private sector, and official multilateral debt.

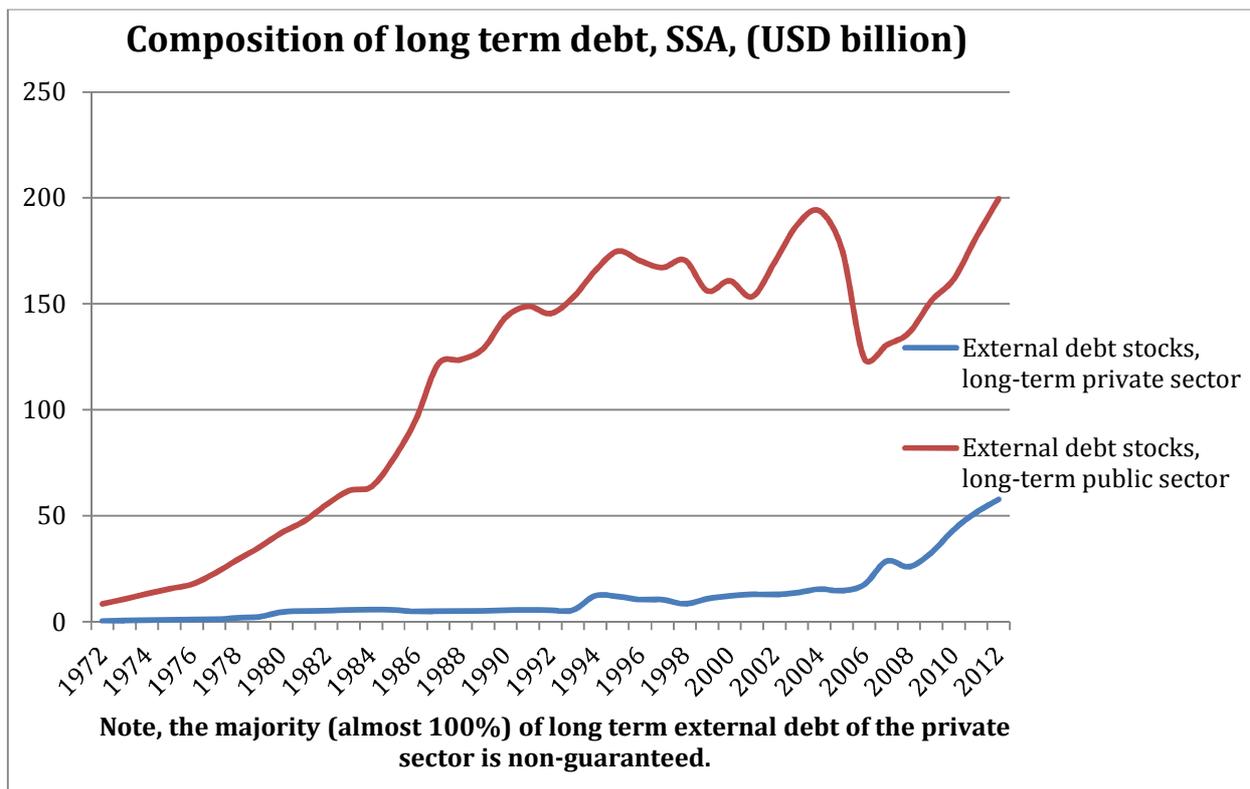
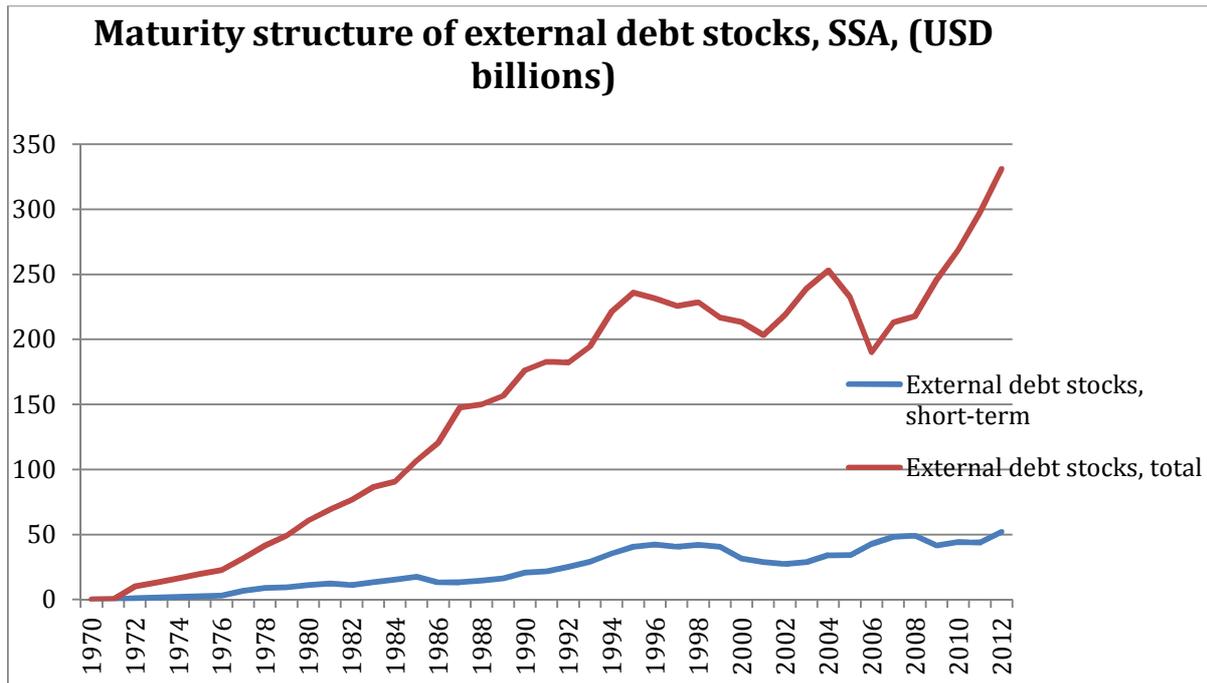


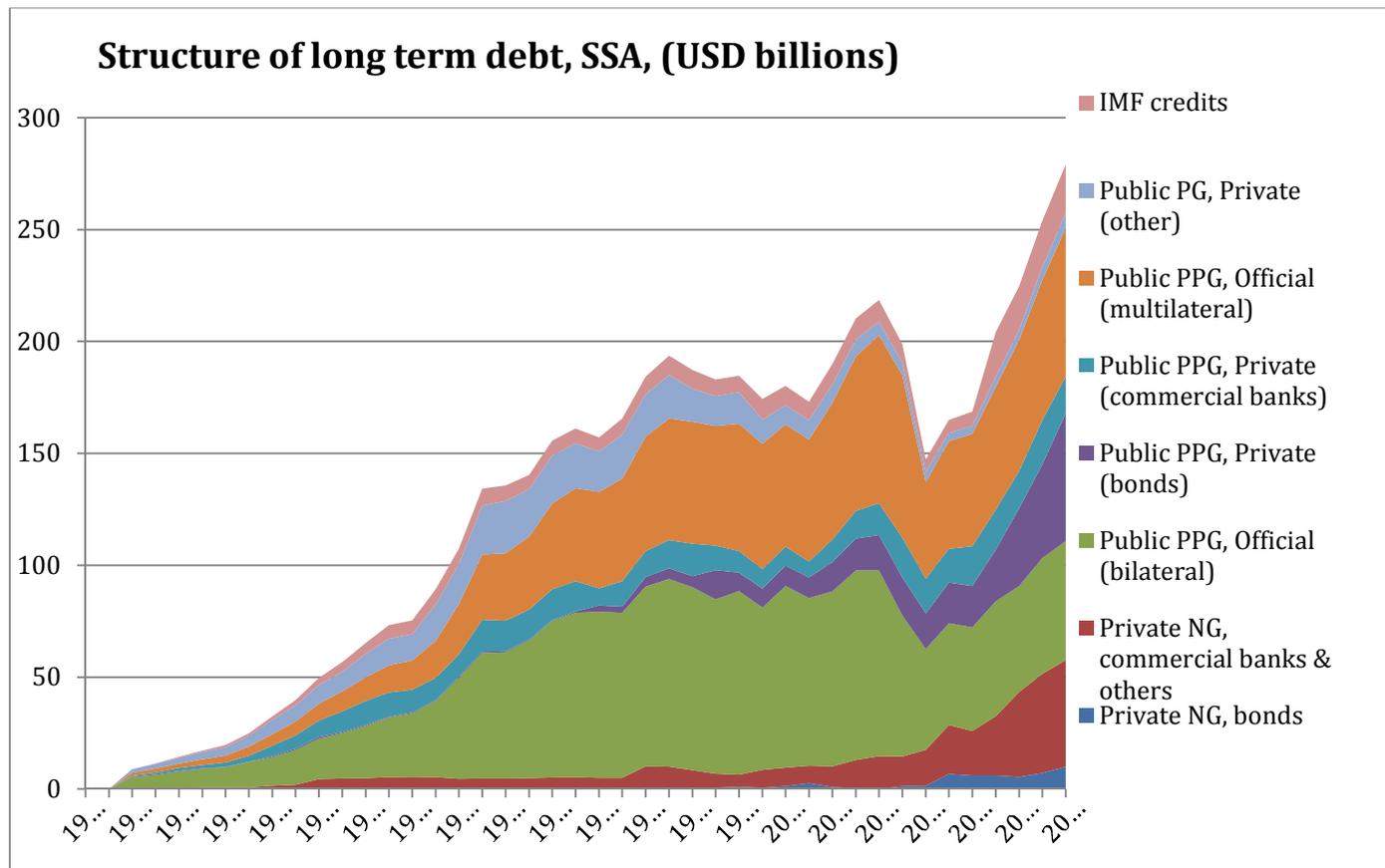


1.4.2 Sub-Saharan Africa⁴

SSA's external debt is mostly long term. Long term external debt has grown steadily since the 1970s to mid-90s, where it fluctuated for ten years, before climbing steeply again from 2006 till the present. Short term debt currently makes up less than a sixth of the region's external debt. Historically, the majority of the region's external debt has been owed by the public sector, as the external borrowings of the private sector have been negligible. However, a small increase was noted in 1995 and a recent steeper increase is visible since 2006. The structure and composition of the external debt of SSA shows that the largest component historically has been official bilateral debt of the public sector and official multilateral debt. Although slightly decreasing in importance, they remain dominant, with increased proportions of external debt being held by the public sector in the form of bonds; this is marginally surpassed by the private sector external bank borrowing. The ability of the private sector to borrow on the capital markets is close to zero.

⁴ Angola Benin (A) Botswana (A) Burkina Faso (A) Burundi (A) Cameroon (A) Cape Verde (A) Central African Republic (A) Chad (E) Comoros (A) Congo, Dem. Rep. (P) Congo, Rep. (P) Côte d'Ivoire (E) Eritrea (E) Ethiopia (A) Gabon (A) Gambia, The (A) Ghana (E) Guinea (E) Guinea-Bissau (E) Kenya (A) Lesotho (A) Liberia (A) Madagascar (A) Malawi (A) Mali (A) Mauritania (A) Mauritius (A) Mozambique (A) Niger (A) Nigeria (A) Rwanda (A) São Tomé and Príncipe (A) Senegal (A) Seychelles (A) Sierra Leone (A) Somalia (E) South Africa (E) Sudan (A) Swaziland (A) Tanzania (A) Togo (A) Uganda (A) Zambia (A) Zimbabwe (A)



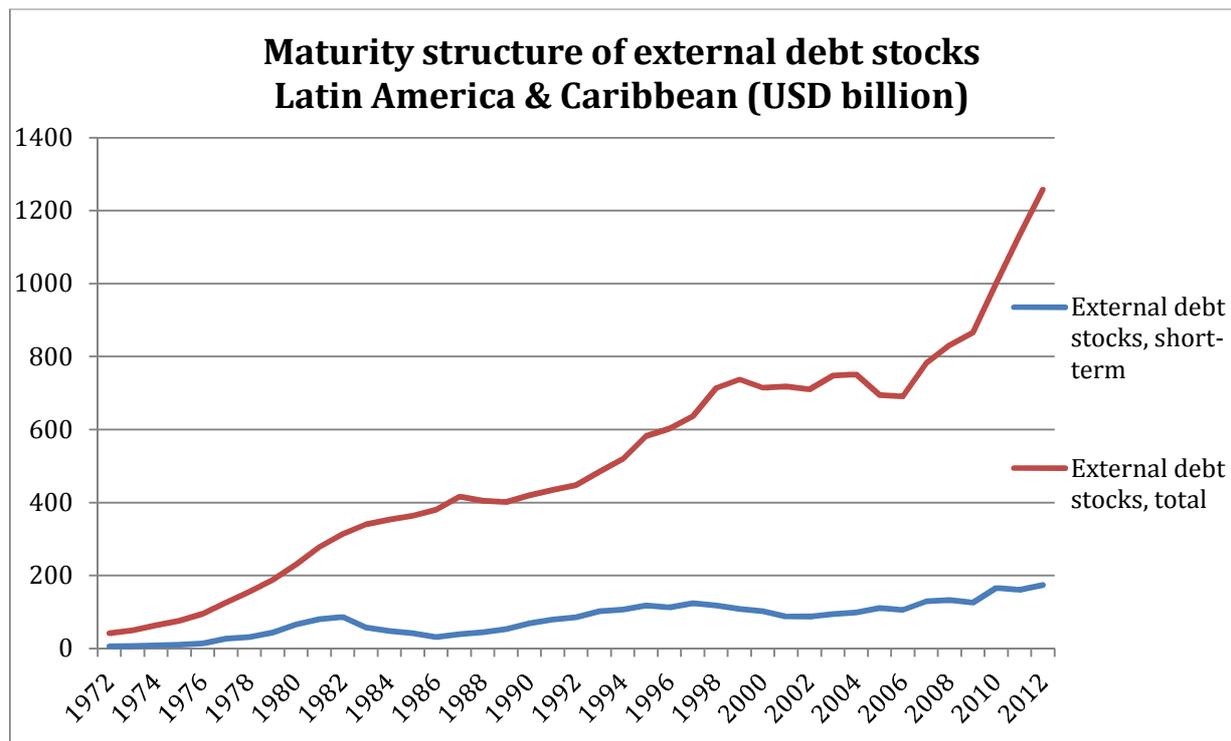


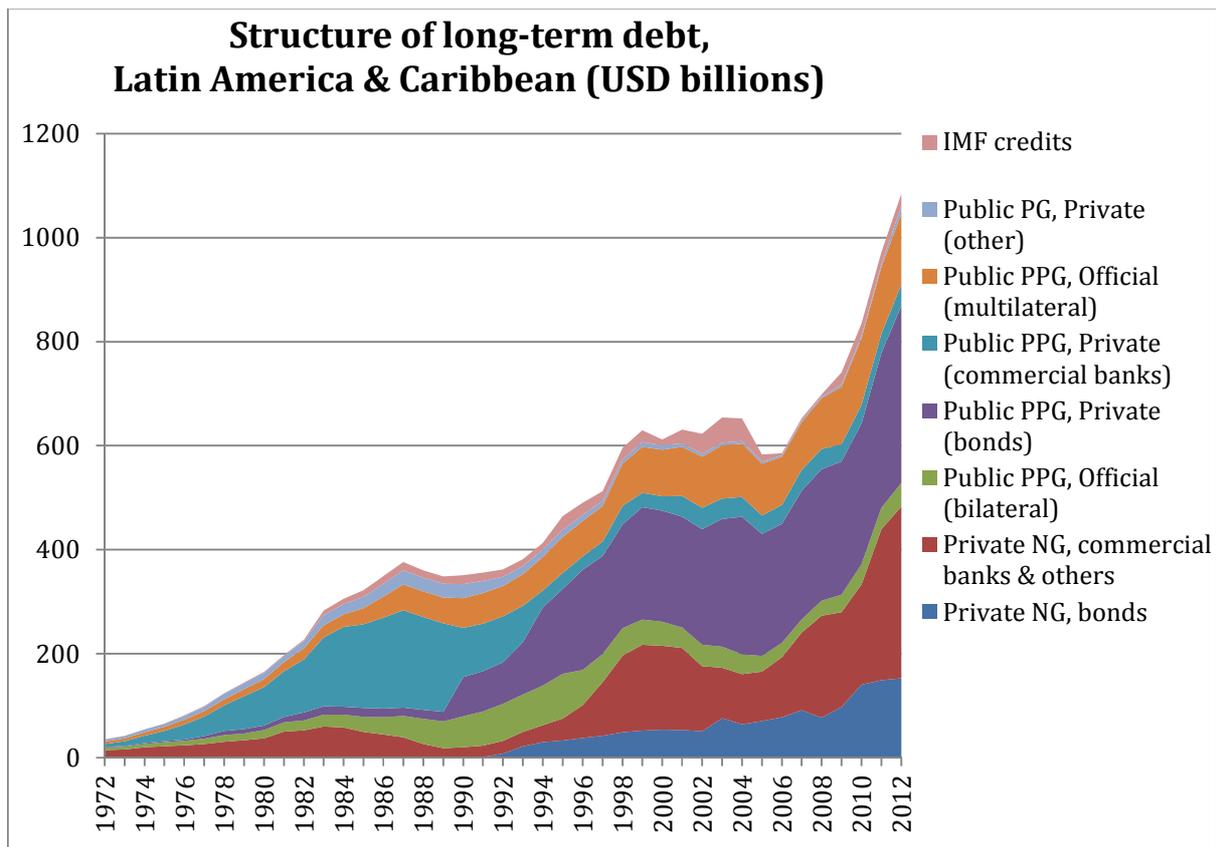
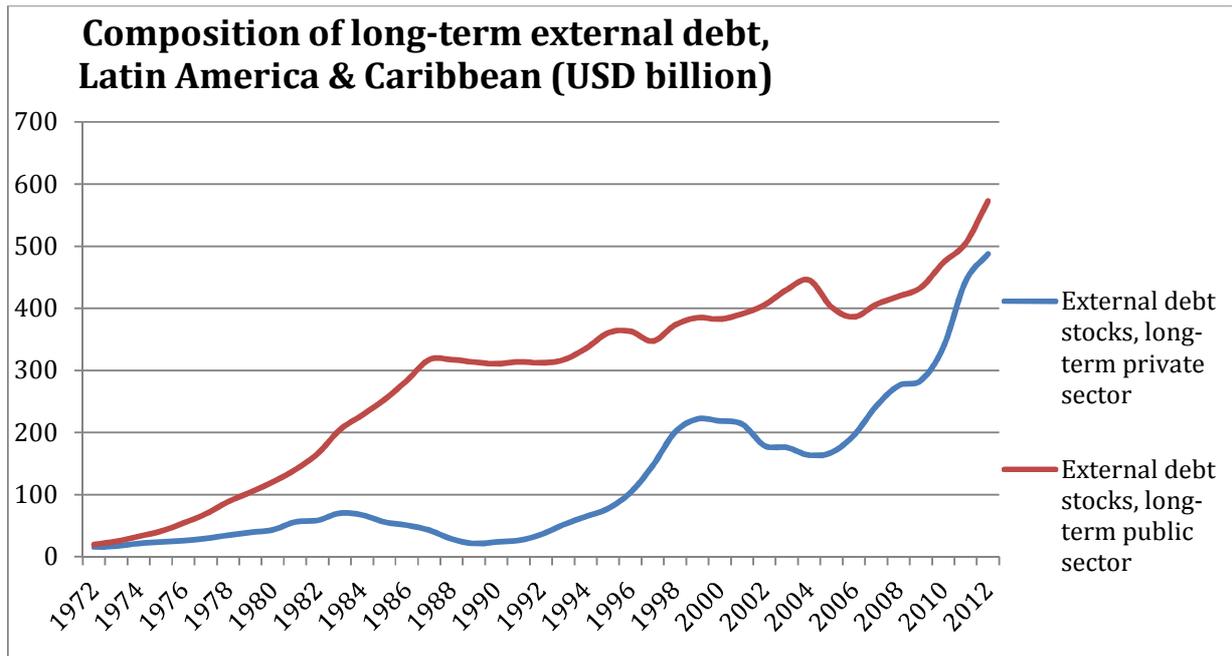
1.4.3 Latin America and the Caribbean⁵

Comparatively to the other regions, LAC has a large external debt, surpassing 1200 billion dollars in 2012. External debt rose steadily from the 1970s till the late 1990s, before remaining roughly constant for 8 years. Since 2006 it has risen steeply. As with the other regions, the bulk of the borrowing is long term, with short term debt comprising less than a sixth of the total, and remaining approximately constant over time. The majority of the external borrowing is done by the public sector, but the private sector's external borrowing is close to surpassing the public's. The private sector external debt growth is driven by non-

⁵Argentina (A) Belize (A) Bolivia (E) Brazil (A) Colombia (A) Costa Rica (A) Dominican Republic (A) Ecuador (A) El Salvador (A) Grenada (A) Guatemala (E) Guyana (A) Haiti (A) Honduras (A) Jamaica (A) Mexico (A) Nicaragua (A) Panama (A) Paraguay (A) Peru (A) St. Lucia (A) St. Vincent and the Grenadines (A) Venezuela, RB (A) American and Caribbean

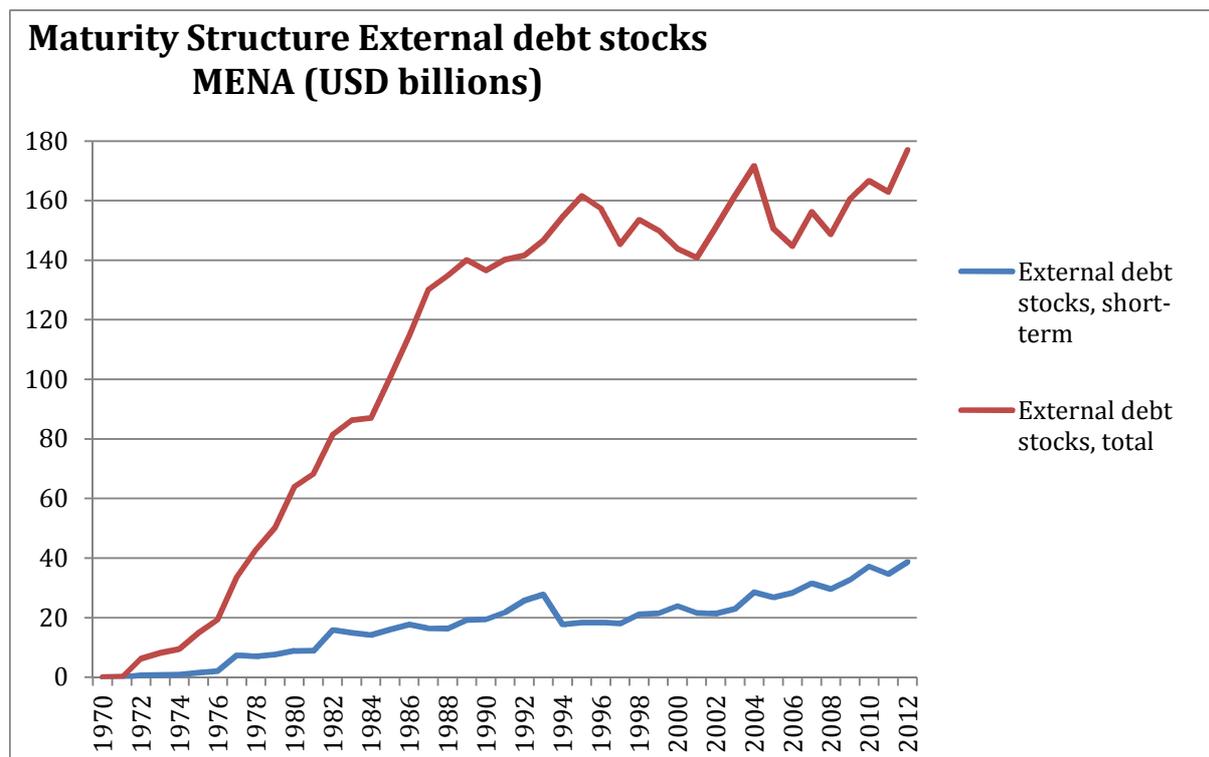
guaranteed bank loans and non-guaranteed bonds. Private sector external borrowing fluctuated reaching a peak in 2000 which subsided thereafter, and started to rise steeply after 2006. Overall, the main components of long term debt are the public sector issuing bonds, the private sector receiving commercial bank loans from abroad, and the private sector issuing non-guaranteed bonds.



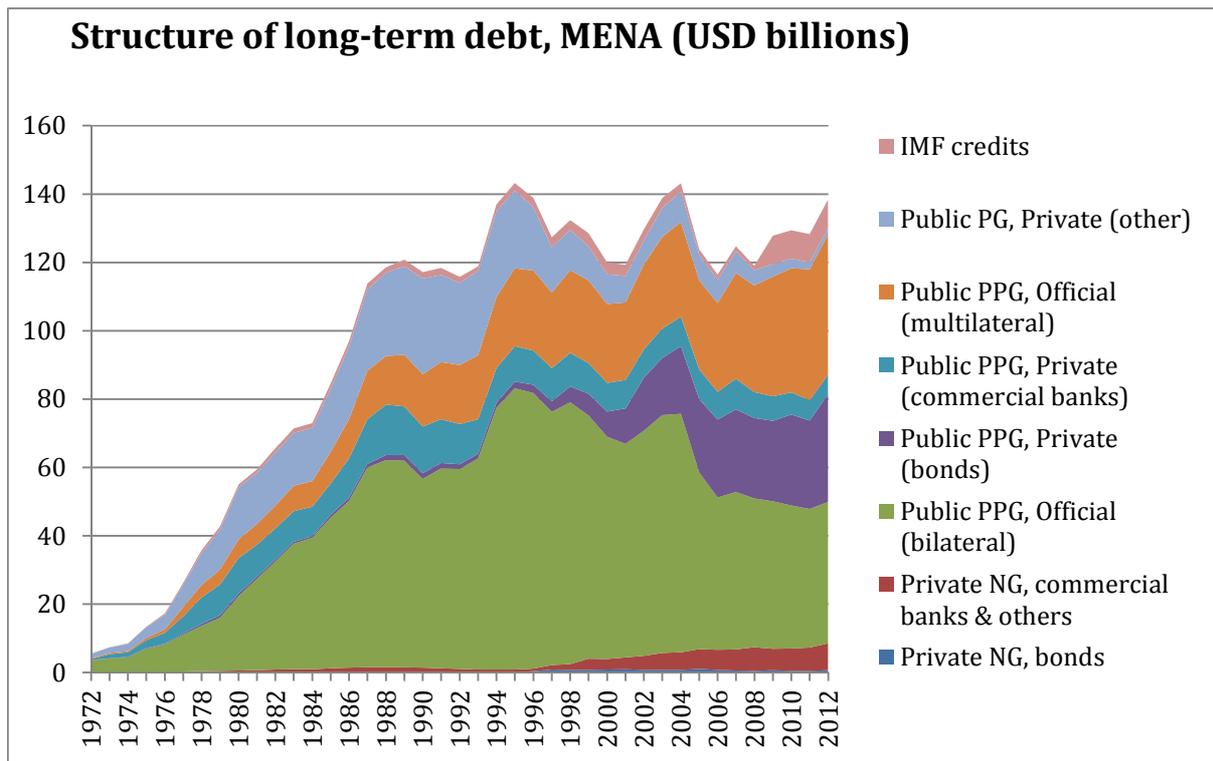
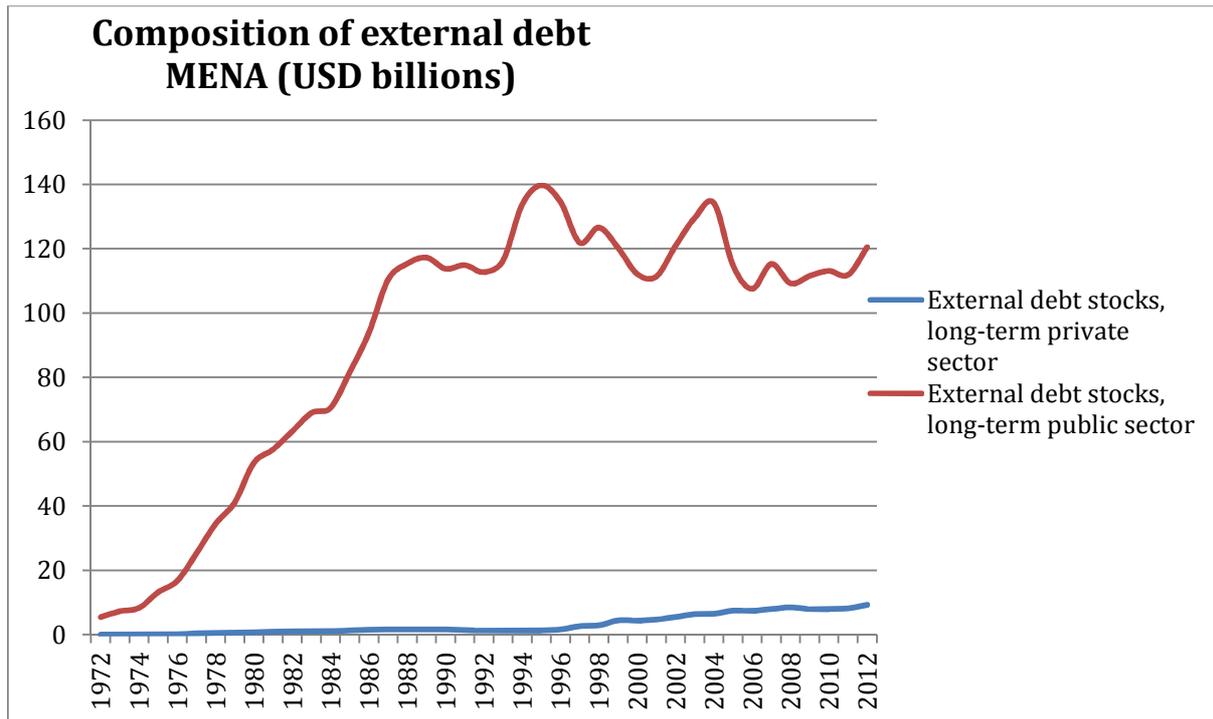


1.4.4 Middle East and North Africa⁶

This region has the lowest external debt out of all the regions. Short term borrowing is close to a quarter of total external debt in 2012, proportionally higher than other regions. Following a steep rise in long term external borrowing from the 1970s to the early 1990s external debt was volatile for the following 15 years, even if not exhibiting sustained increases as the other regions have. The fluctuations are entirely down to public sector fluctuations, which make up the bulk of external debt, as up to 1996 the private sector had close to zero external debt and since has risen slightly. If we look at the components of external debt in more detail, we see that the bulk of the MENA's region external debt is official bilateral debt, with an increasing multilateral component. Since 1996 the public sector has also been issuing bonds which have risen to the third major component of the region's external debt. IMF credits have become significant since 2008.



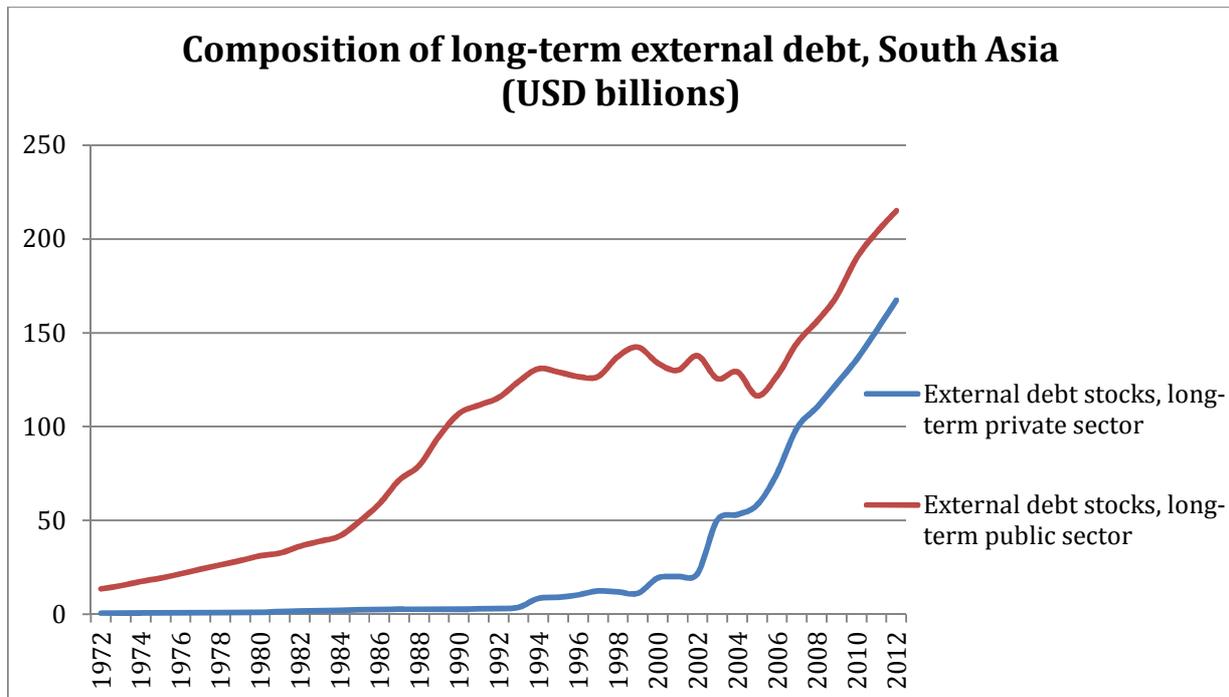
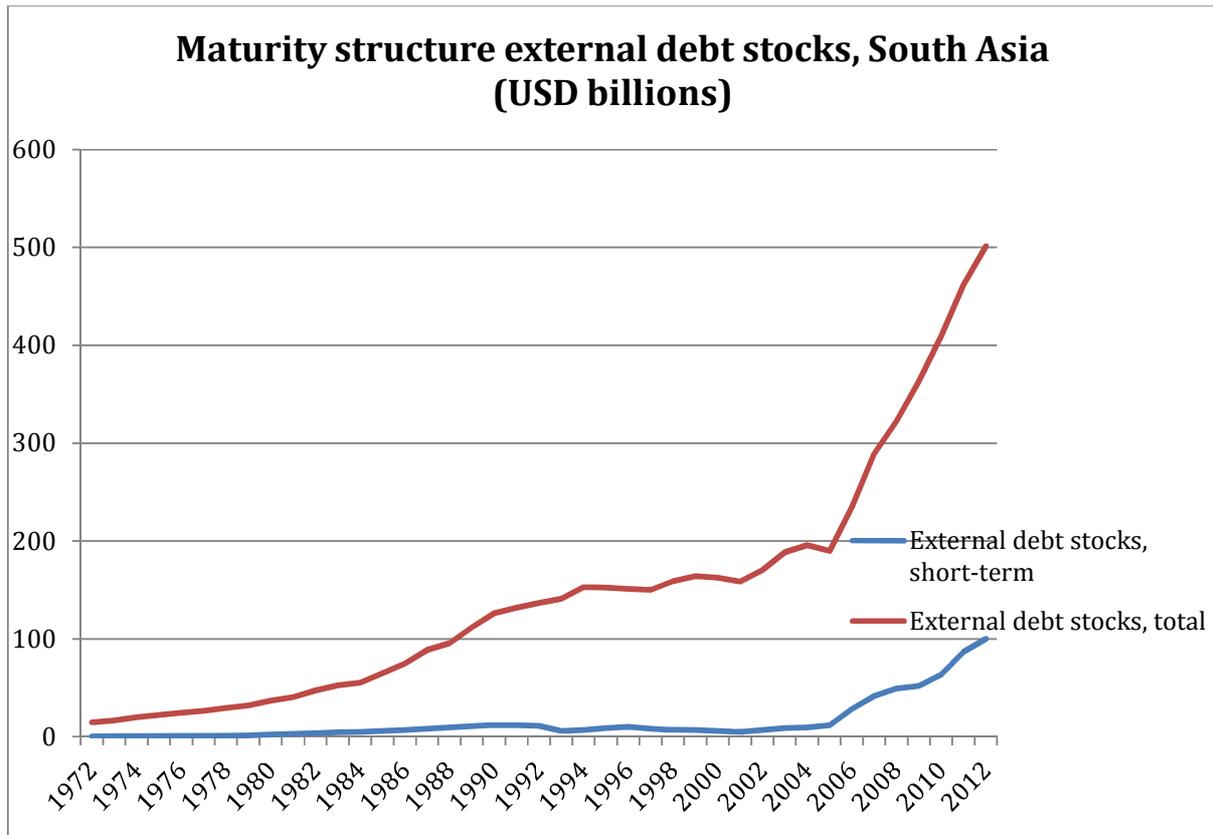
⁶ Algeria (A) Djibouti (A) Egypt, Arab Rep. (A) Iran, Islamic Rep. (A) Jordan (A) Lebanon (A) Morocco (A) Syrian Arab Republic (E) Tunisia (A) Yemen, Rep. (A).

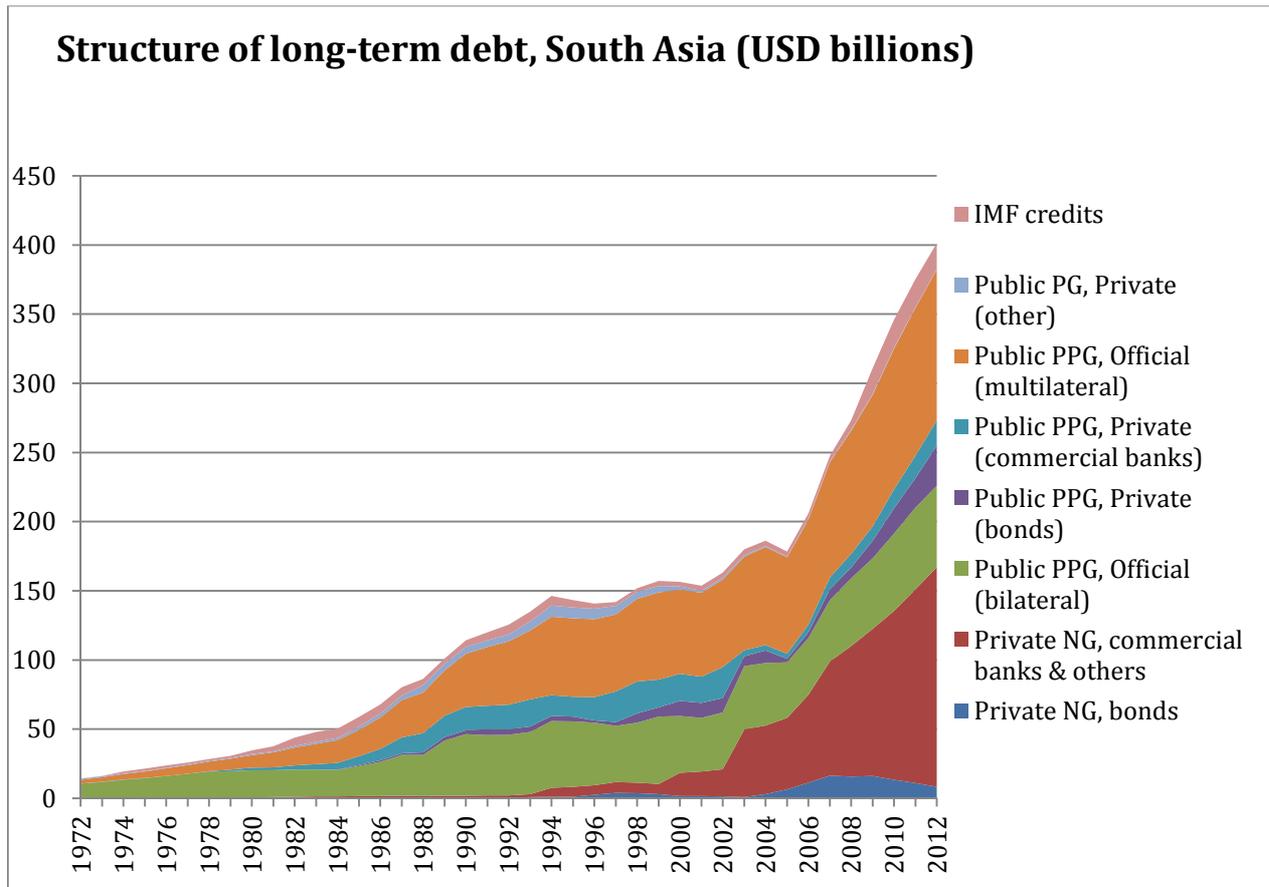


1.4.5 South Asia⁷

South Asia's external debt amounts to \$500 billion in 2012, the majority of which is long term, with short term debt constituting a fifth of the total. The steep rise in external debt began in 2005. The borrowing sector has been largely the public sector. Up to the year 2000 the private sector borrowed little internationally, however, since 2005 there has been a sharp increase that rose to mirror the borrowing levels of the public sector. The public sector's external borrowing also rose steeply since 2006. Historically, the main components of external debt were official bilateral debts and official multilateral debts to the public sector. Since 2002, cross-border, private-sector non-guaranteed bank loans have increased dramatically, rising to the scale of official flows.

⁷ Afghanistan (A) Bangladesh (A) Bhutan (A) India (A) Maldives (A) Nepal (A) Pakistan (A) Sri Lanka(A)



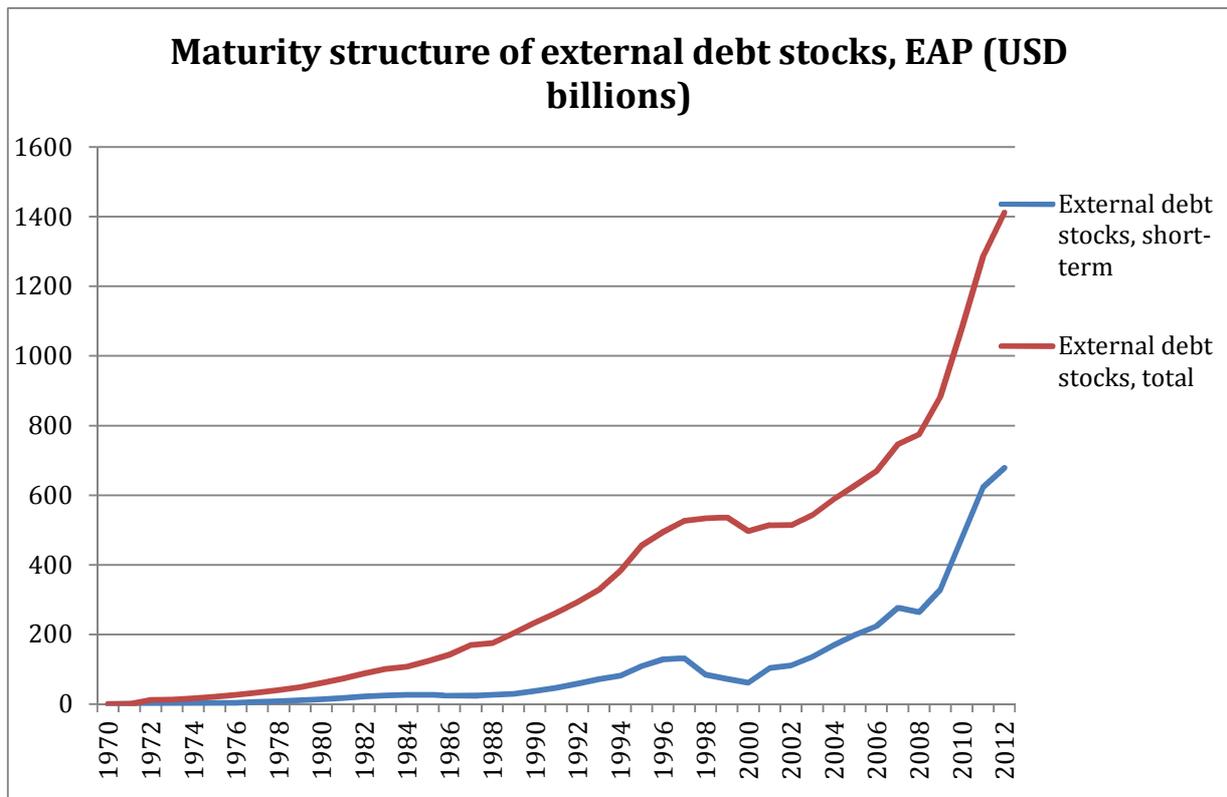


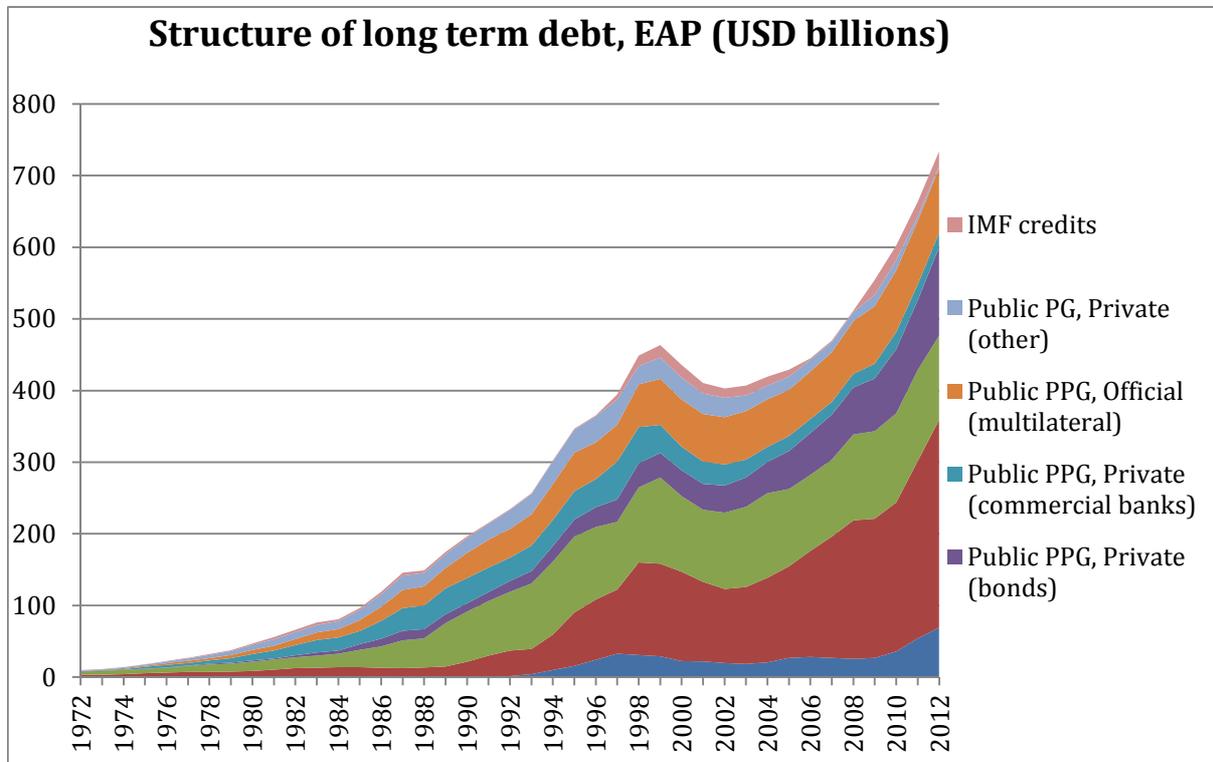
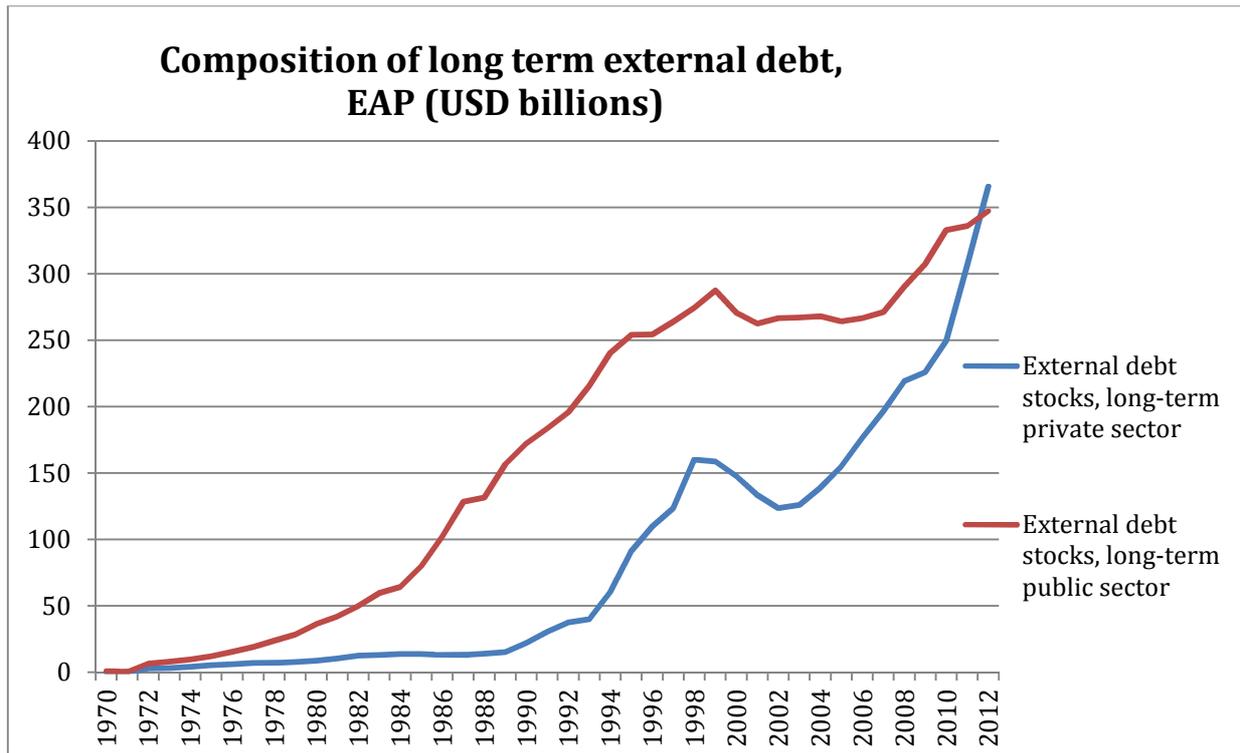
1.4.6 East Asia Pacific Region⁸

The region's external debt is characterised by short term external debt which is close to half of the total. The gradual increase in short term borrowing abroad began in 2000 which rapidly increased after 2008. This *may* be related to the international investors looking to place their money elsewhere in the midst of the global financial crisis, however as the increase has been sustained since 1990, despite the steep drop during the crisis in 1997/8, it is reasonable to assume that the short term debts are associated with trade credits. Private

⁸ Cambodia (A) China (E) Fiji (A) Indonesia (A) Lao PDR (P) Malaysia (E) Mongolia (P) Myanmar (E) Papua New Guinea (A) Philippines (A) Samoa (A) Solomon Islands (A) Thailand (A) Tonga (A) Vanuatu (E) Vietnam (A)

sector external borrowing rose to a peak in 1999 before collapsing briefly in the early 2000's. It has since risen abruptly and now surpasses the public sector's borrowing abroad. The main components of external debt are private non-guaranteed bank loans. Other main components are official flows (bilateral and multilateral) as well as public sector and private sector bond issuance.





1.5 Additional debt indicators

This section compared various debt indicators across regions. We are not interested in assessing debt sustainability in the formal sense, as this is done on a national level. Regional aggregation tries to create a primary assessment of what the external obligations of the regions look like. There are no internationally accepted benchmarks for assessing debt sustainability, as over time different methodologies for criteria and thresholds have been used, such as the Enhanced HIPC initiative, or the Debt Sustainability Analysis. Although the criteria of the IFI's are not without problems, we will utilise the benchmarks of the HIPC initiative to compare debt indicators across countries.

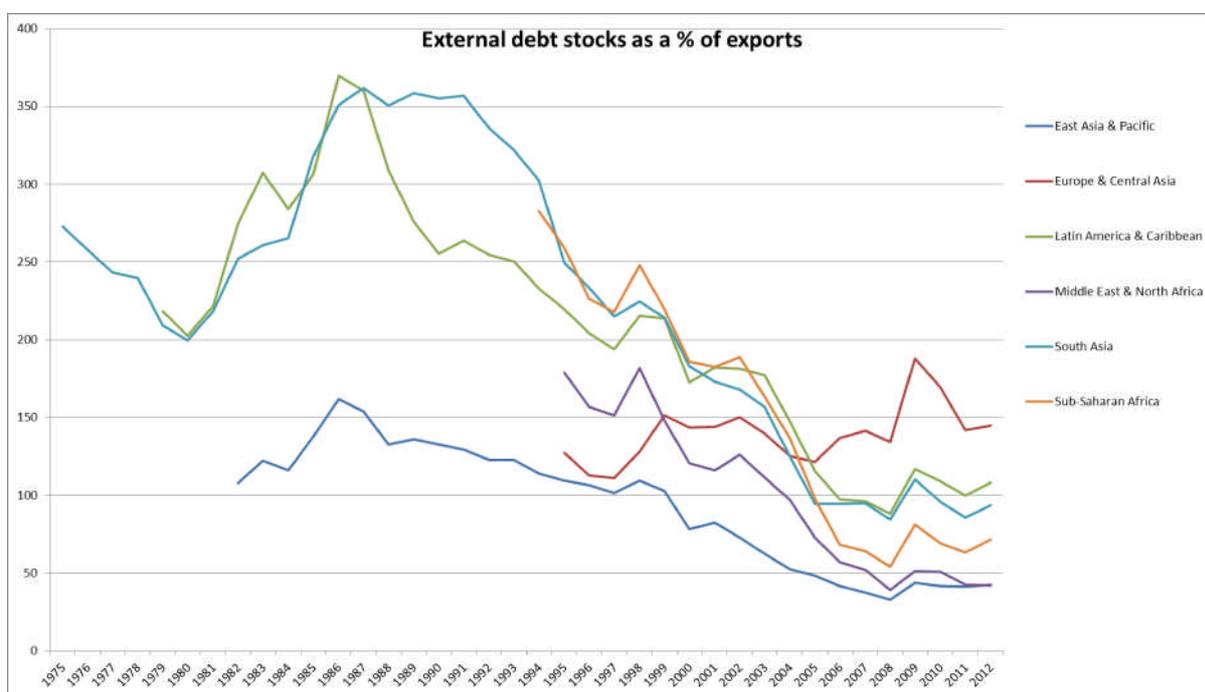
Debt relief programmes such as the HIPC initiatives and the MDRI have played their part in improving debt servicing capabilities of developing countries, although this is more noticeable on an aggregate level. Problems faced by these programmes are that in certain circumstances, such as Mozambique, Ethiopia or Niger, their debt sustainability post-debt relief approaches the circumstances pre-relief. Furthermore, the literature on financial crisis has pointed to the rapid increase in incidences of default and debt restructuring in the last three decades than in the decades preceding it.

On the whole debt indicators try to assess the solvency and liquidity of borrowers. Liquidity burdens are usually assessed by measuring flows, such as the levels of annual debt repayments against the revenues that are available to repay external debts (such as export incomes, or government revenue) that year. Solvency issues are assessed by comparing stocks of debt to, for example, the size of the debt to the overall economy.

Under the HIPC initiative, sustainability is defined as the present value of debt as a proportion of exports being under 150%, and present value of external debt as a proportion of budget revenue at under 250%, and debt service to export earnings to be less than 15-20%. The approach to assessing sustainability evolved into a more complicated assessment configured by the IFIs called the Debt Sustainability Framework, which defines sustainable thresholds according to the assessment of the quality of the institutions. Under this methodology, the

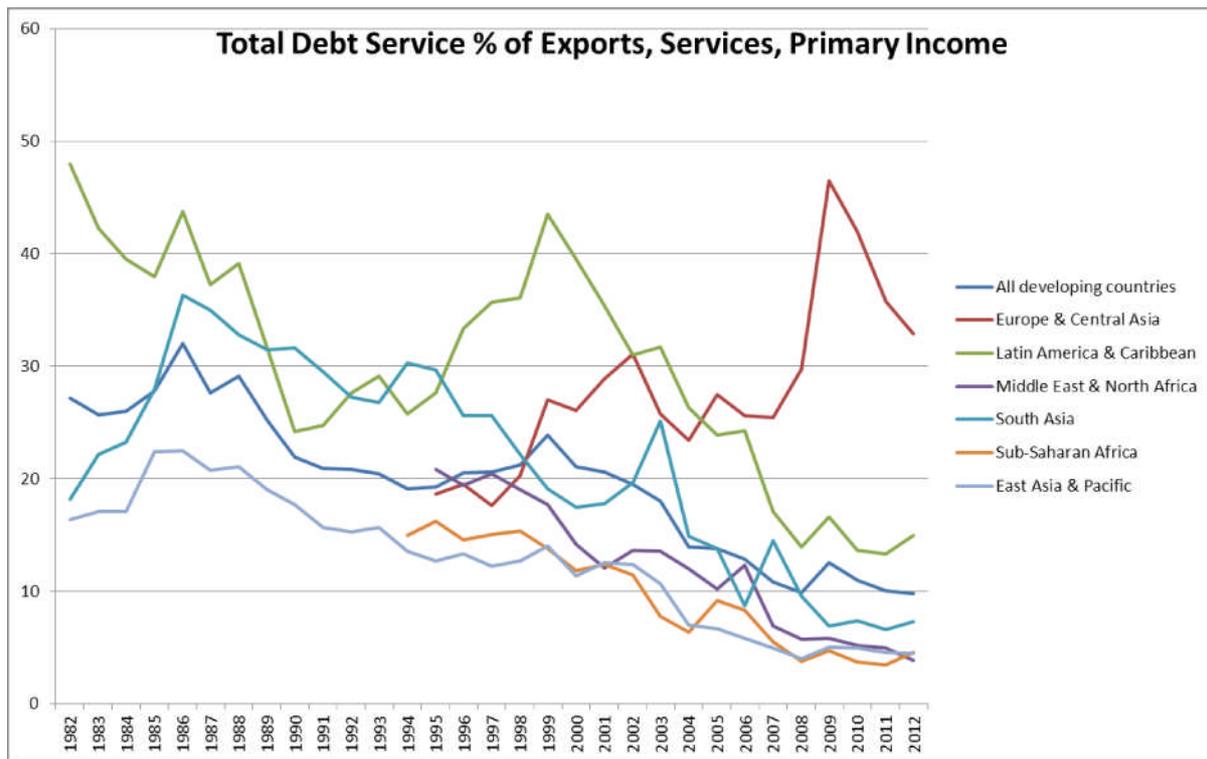
criteria for sustainability of external debt to exports country deemed to have poor institutional strength, is lower than the HIPC indicator, at 100%.

Under the HIPC indicators, the only region currently to fall within one of these thresholds is Europe and Central Asia (ECA) largely as a result of the crisis since 2008. Under the DSF we can add LAC and SA to the regions which are hovering in and out of the sustainable threshold since 2006 onwards.

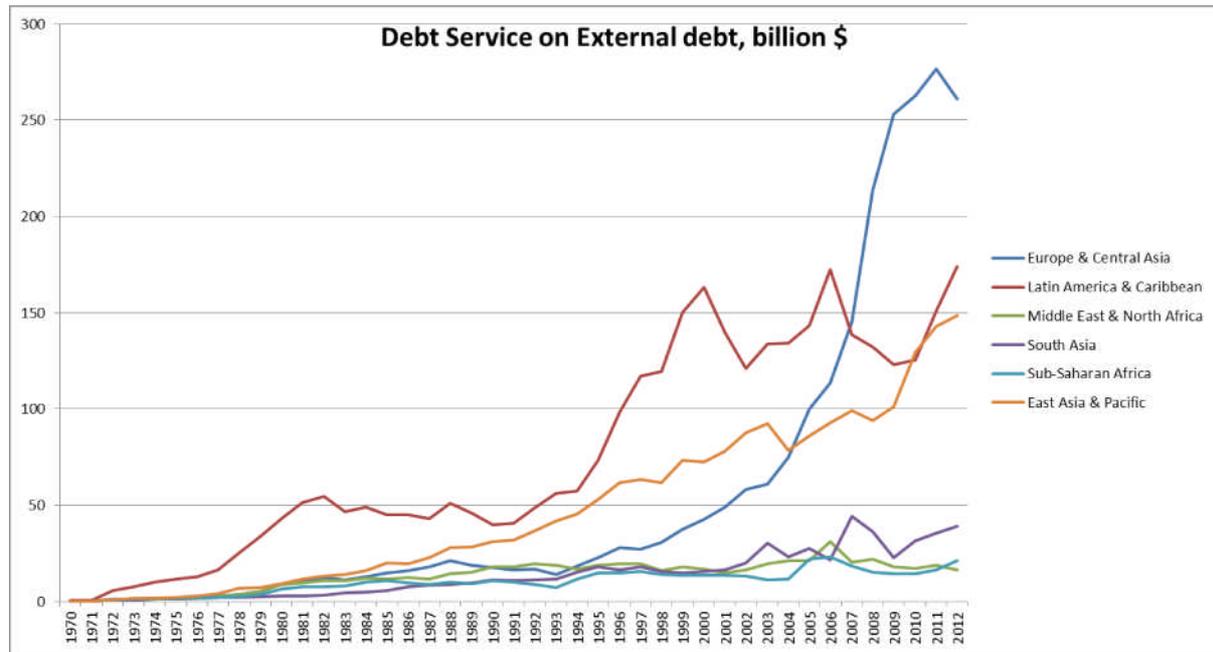


3.4.1 Debt service

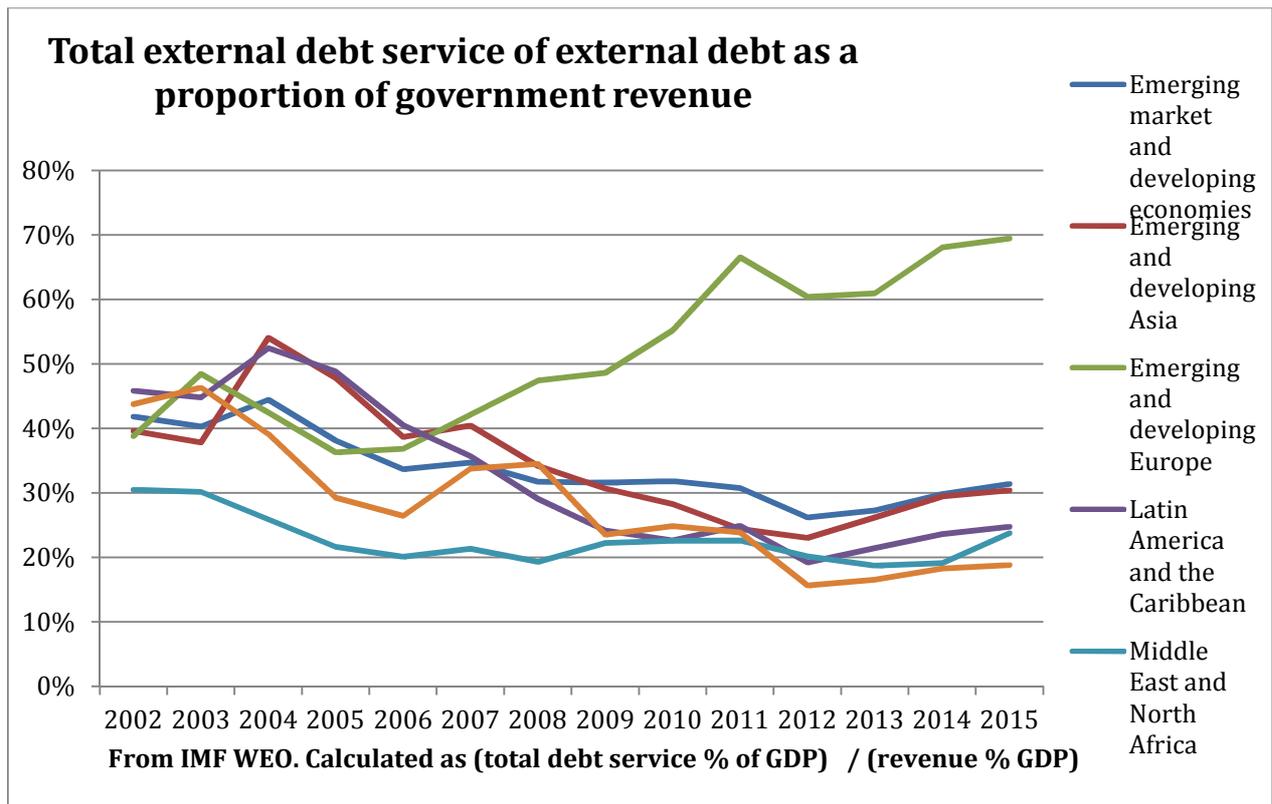
A liquidity indicator used by IFIs is that the debt service to exports ratio, with the HIPC indicator defining sustainable as 15 – 20 %. Looking at the debt repayment burden vis-a-vis income earned from exports, services and primary income provides a way to assess whether there are any impending liquidity problems likely to arise in meeting external debt payments on time. Our aggregation is regional and not by income, so the graph cannot be used to assess debt sustainability as defined above. However, using the criteria as a guideline, we can see that the only regions to exceed this threshold after 2004 are LAC and ECA.

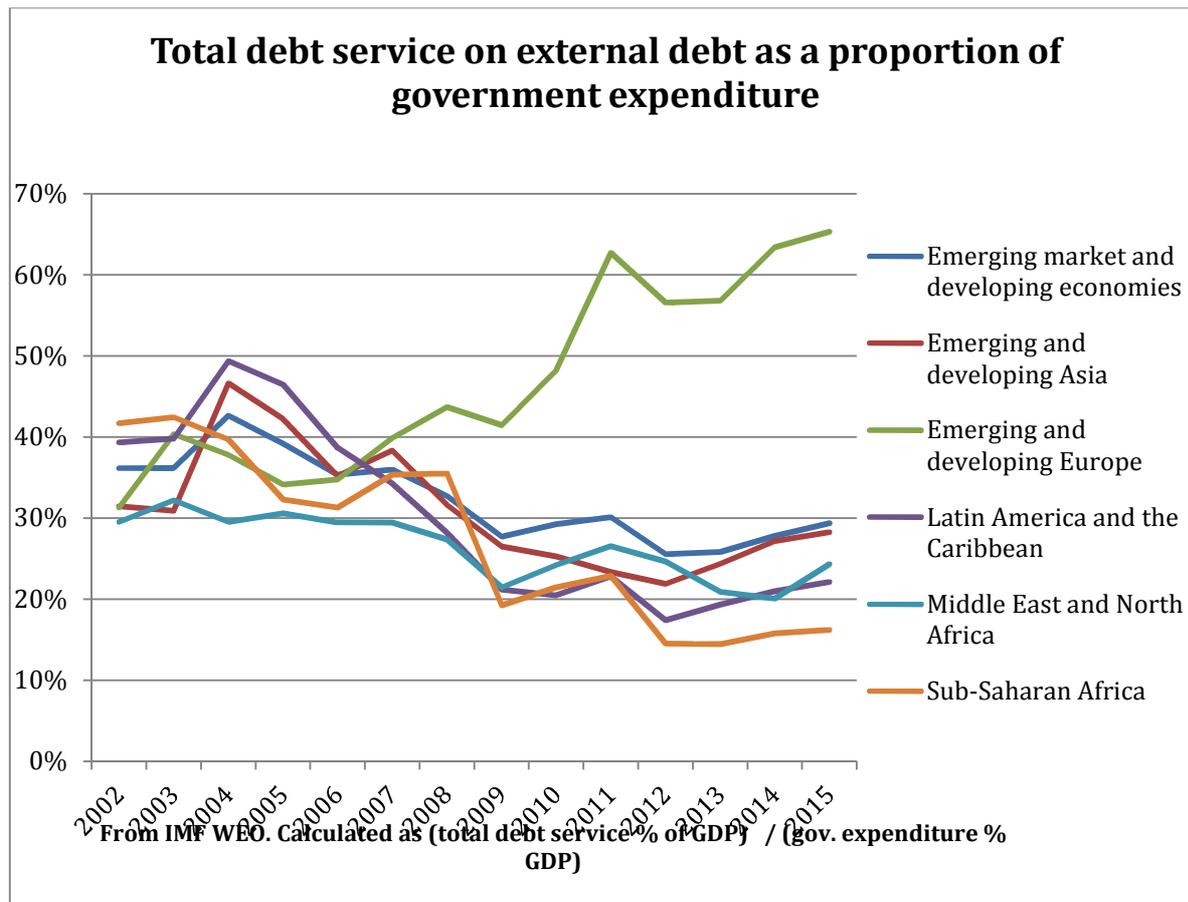


In absolute terms however, the debt service on external debt is growing. Measured in billions of dollars, the following graph shows the annual flows spent on debt service by each region. A rapid increase in debt service on external debt is shown by ECA region since 2004, with LAC and EAP regions showing an increase in debt service payments since 2008.



The 'Budget service ratio' is a measurement of the ability of a government to repay external debt from domestic resources. Under the DSF, the maximum that is deemed sustainable for a country whose institutional strength is weak is that total debt service is no more than 25% of domestic budget revenue. Emerging and developing Europe's indicators has skyrocketed, and on the antipodes, the MENA region's has since 2004 been consistently below threshold. All other regions' indicators have come down from the early 2000s, they still hover around the threshold from 2009.

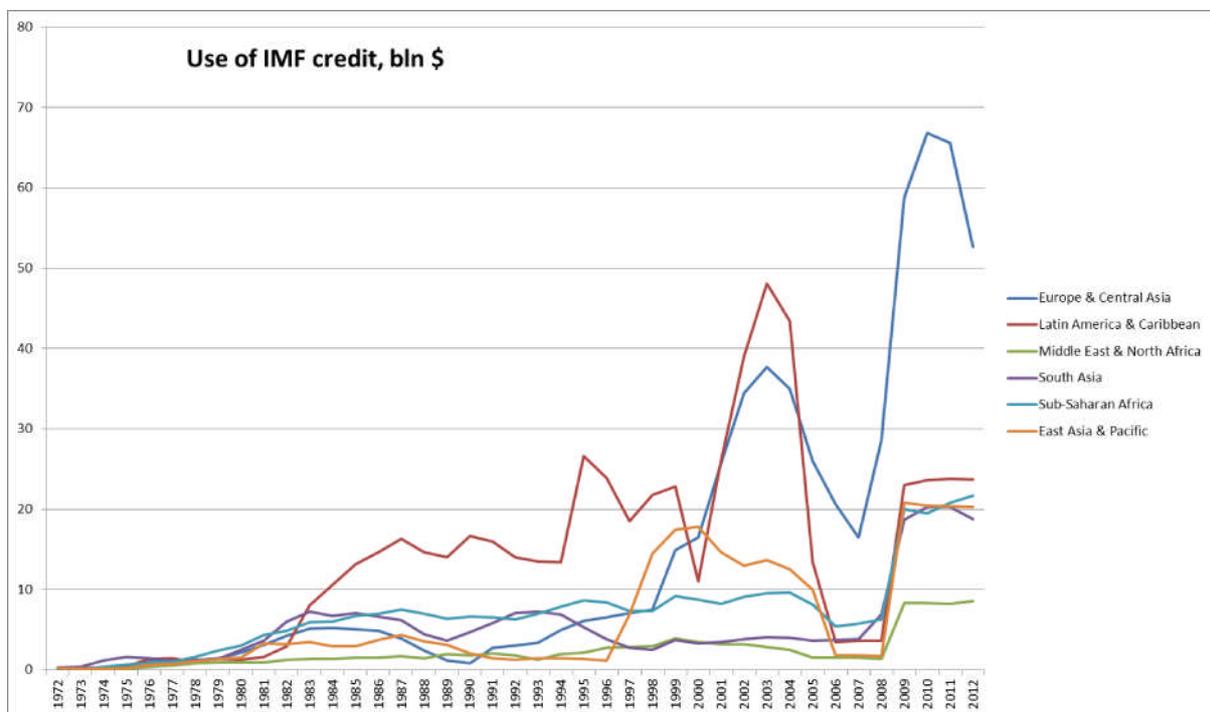




1.5.1 Arrears, IMF credits and default risk

Receiving funds from the IMF indicates that a country is unable to meet its external obligations, and so is reliant on the IMF supplying those funds, conditional on an extensive structural reform programme. As of September 2014 there were 35 countries receiving IMF credit (IMF, 2014). These were Bosnia and Herzegovina, Georgia, Jordan, Romania, Tunisia, Ukraine (all under a Stand By Agreement); Albania, Armenia, Cyprus, Greece, Jamaica, Pakistan, Seychelles (all under Extended Fund Facility); Colombia, Mexico, Poland (under the Flexible Credit Line); Morocco (under a Precautionary and Liquidity Line), Afghanistan, Bangladesh, Burkina Faso, Burundi, Chad, Cote d'Ivoire, Gambia, Grenada, Guinea, Haiti, Liberia, Malawi, Mali, Niger, Sao Tome & Principe, Sierra Leone, Solomon Islands, Yemen (all under the Extended Credit Facility).

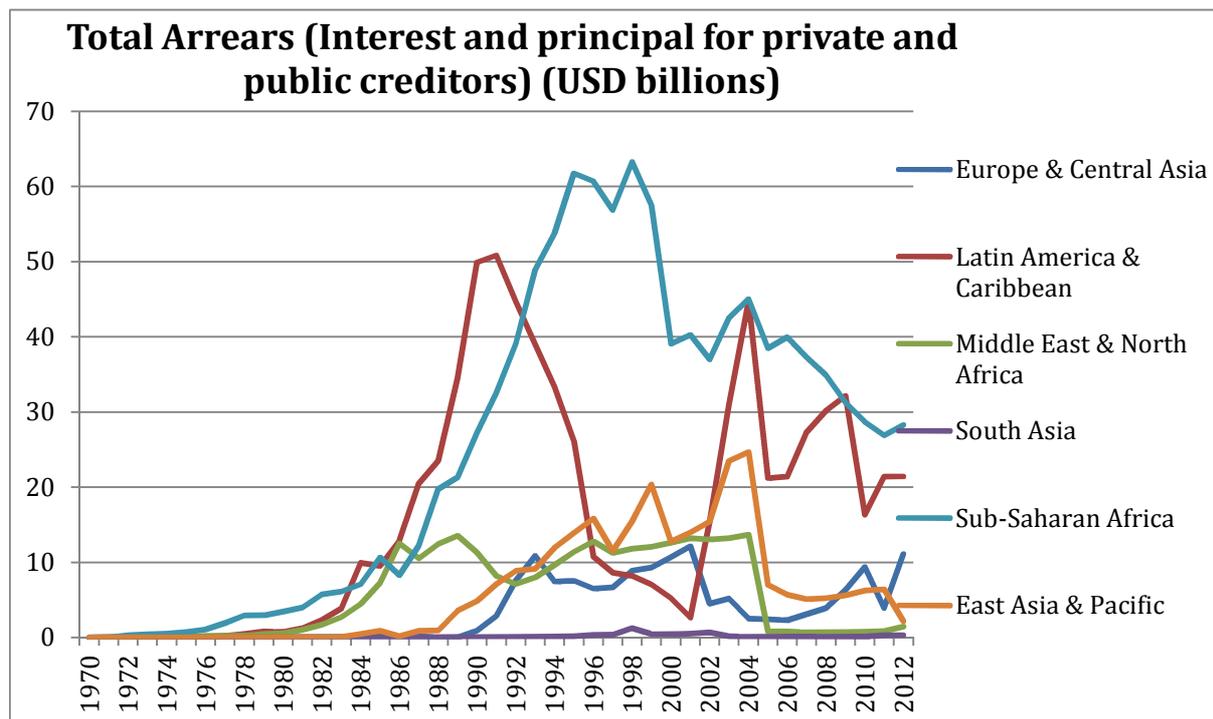
The use of IMF credit may also act as an indicator of access to other financing sources, as presumably increased use to IMF credit indicates less stable financing conditions elsewhere. Officially, the IMF was relied upon to address balance of payments problems. The use of IMF credit in absolute numbers is dominated by ECA, which is not surprising considering that many of the countries that suffered extensively in the global and European financial crisis are in this region and accessed official funds. These countries include Romania, Hungary, Turkey, and Ukraine. All other regions have experienced a rise in the use of IMF credits since the global financial crisis.



The risk of default is also assessed, and as of August 2014 the IMF and World Bank (IMF, 2014b) have assessments of 74 low and middle income countries, of which:

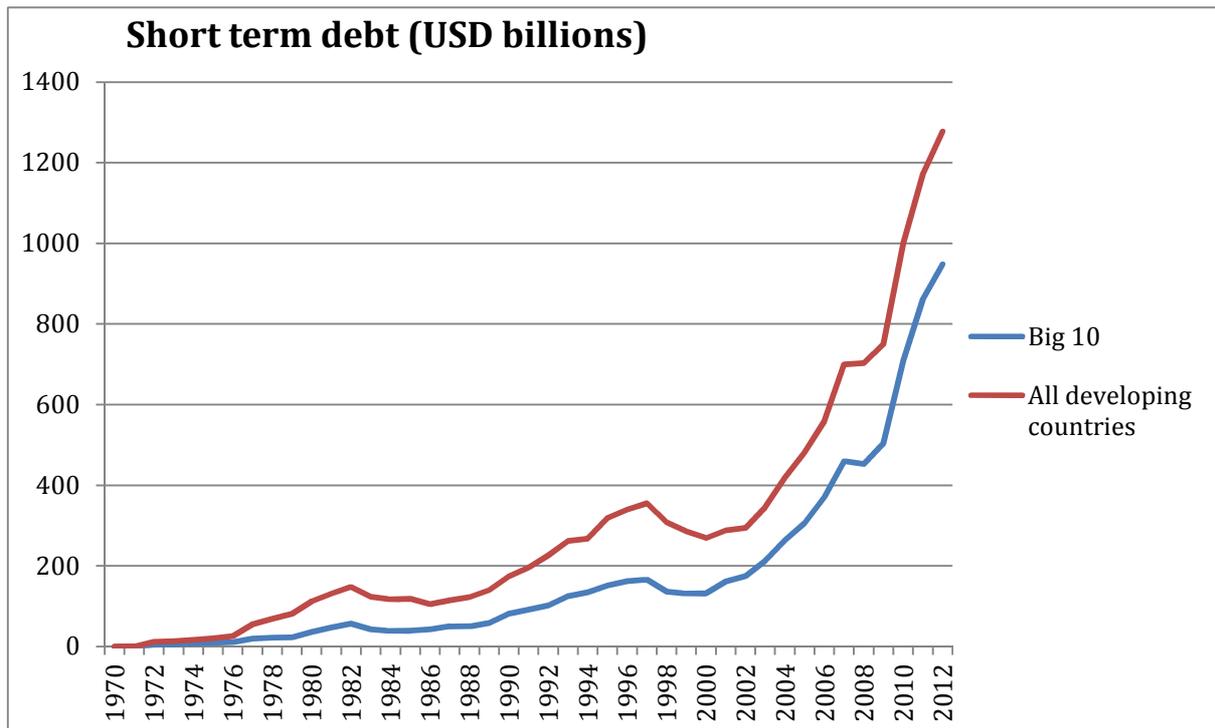
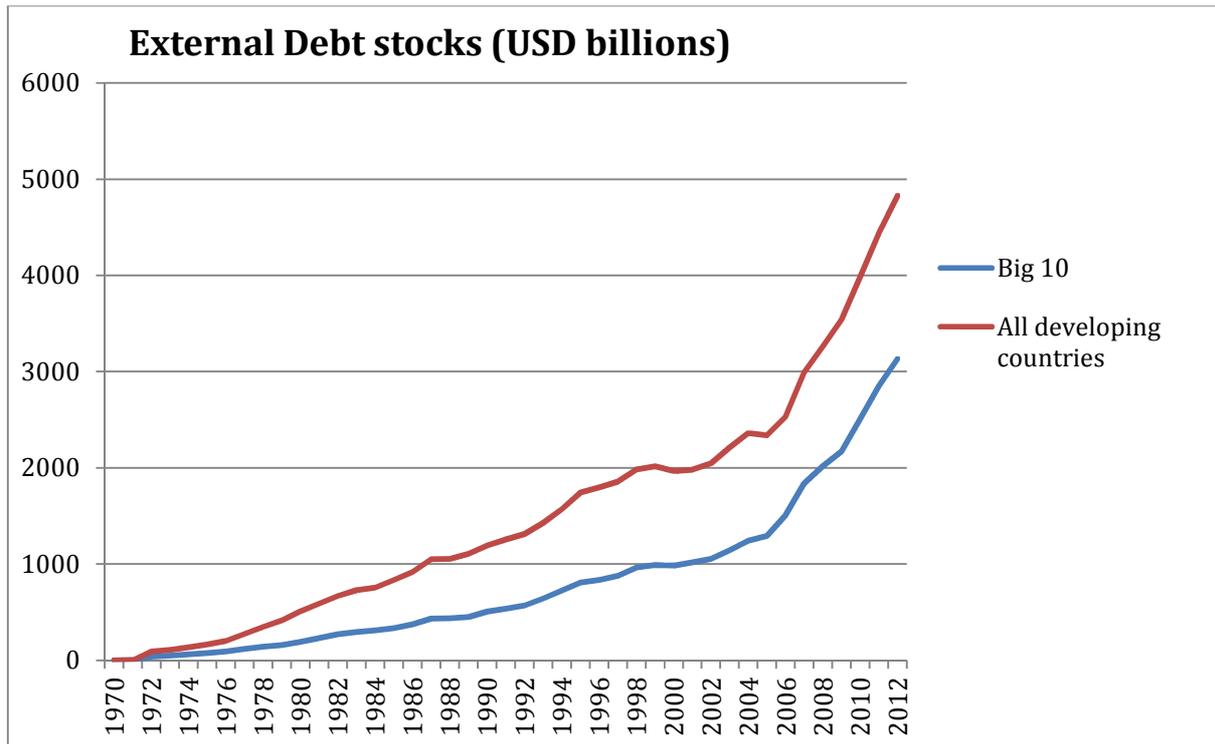
- 2 countries are in debt distress
- 15 countries are at high risk
- 27 countries are at moderate risk
- 23 countries are at low risk of debt distress.

Difficulty in repaying debt results in the accumulation of arrears. The situation across regions varies hugely, and is likely to be driven by a handful of countries in each case that have come up against repayment problems. In any case, SSA had the largest problem of accumulating arrears, which has since the late 90s decreased significantly. The same is true for LAC.



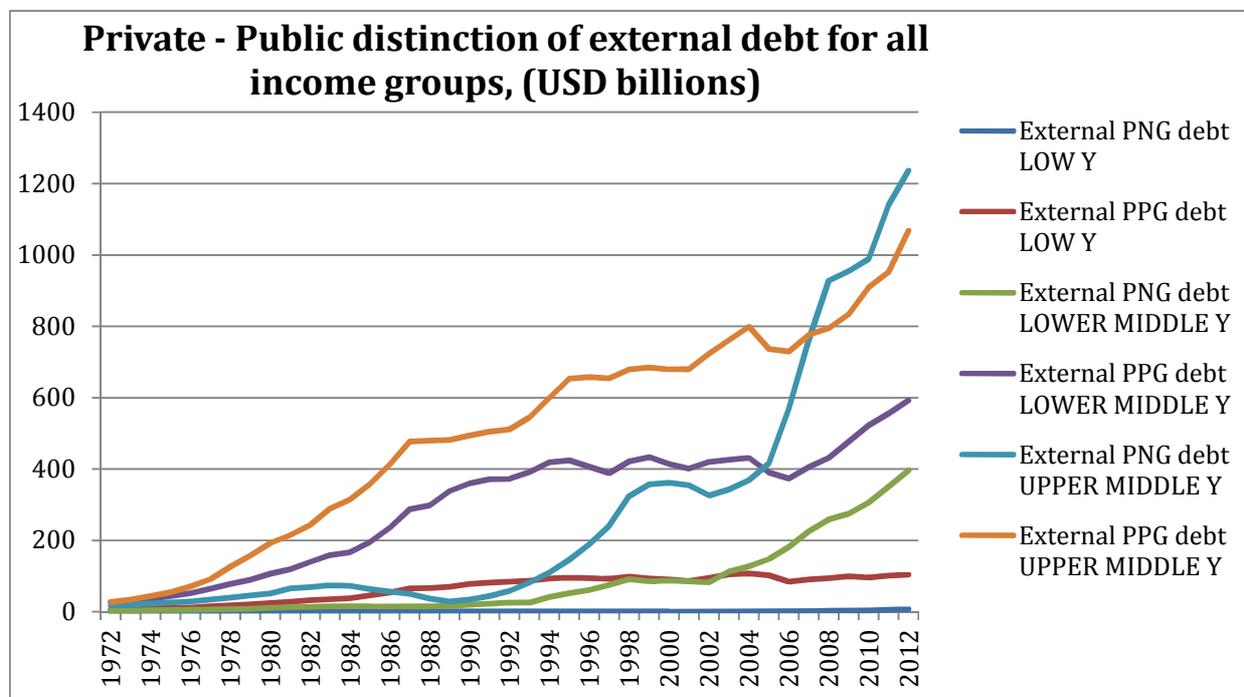
1.6 A look at the big and small borrowers

Although we can identify various trends in the external debt of developing countries, the diversity cannot be overstated. Just ten countries out of the 124 countries that report to the WB IDS comprise 65% of total developing country external debt. Having aggregated these within the regional groups, the trends in financing of other countries may be masked by the large volume of debt flows of a few countries. These ten countries are: China, Brazil, India, Mexico, Turkey, Indonesia, Hungary, South Africa, Kazakhstan and Ukraine.¹

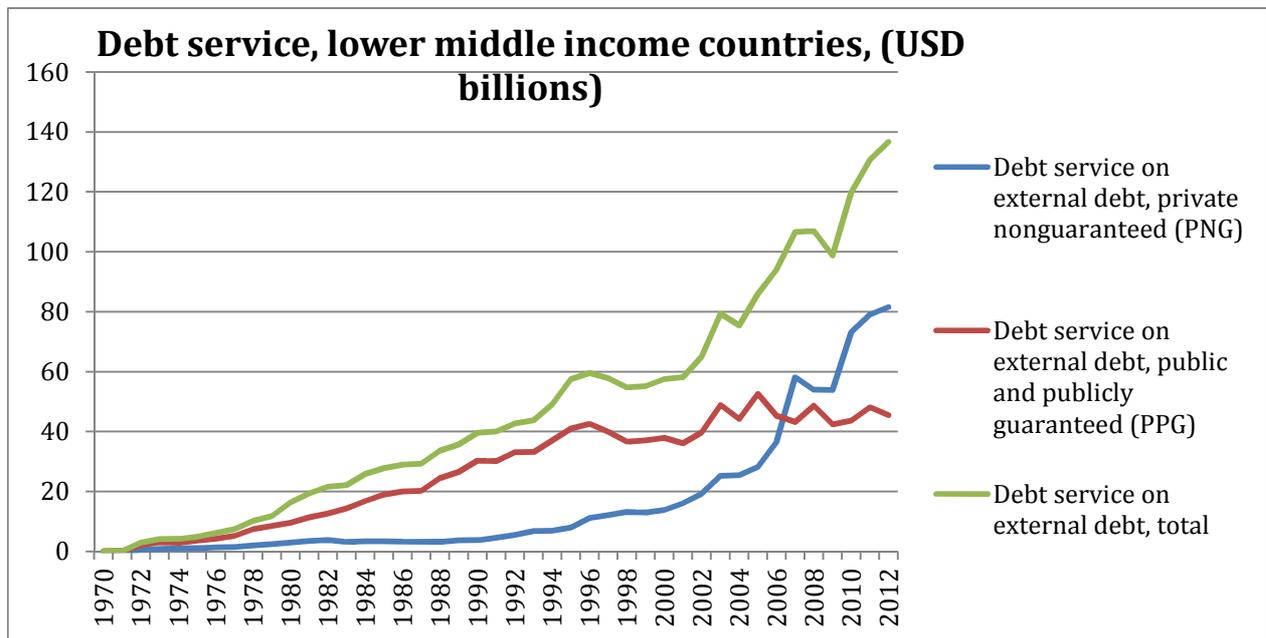


1.7 Debt analysis by Income Group

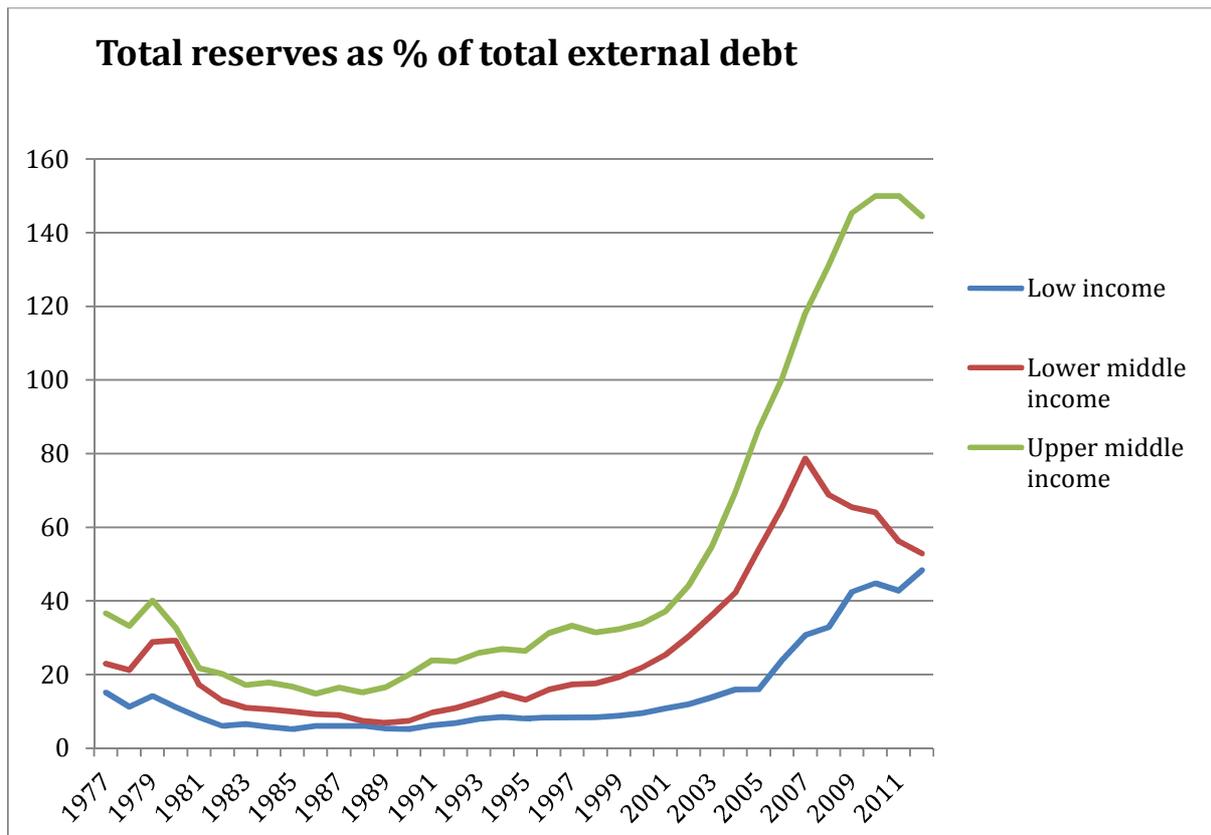
In this section we examine the composition of external debt by income group. We will look at the varying patterns of external borrowing as income changes. The main division in type of debt examined below is in PNG (Private non-guaranteed) and PPG (Public and publicly guaranteed) external debt. By plotting all three income groups in one figure we see that for low income countries, PNG is close to zero and PPG debt is steady and low in comparison to other income groups. For lower middle income groups, external PPG debt is currently approximately a third higher than PNG debt. PNG debt has rapidly converged with PPG debt, despite the fact that until 2005 it was PPG debt that made up the majority of lower middle income countries' external debt. For upper middle income countries, external PNG debt surpassed external PPG debt in 2005, after a very steep rise since 2004. Be it by the public or private sectors, the rate of accumulation of external debt has increased rapidly from the mid-2000s for both lower and upper middle income countries.



The repayment burdens are not directly concurrent to the borrowing sectors, as at least partly, interest rates on the private debts are higher. For lower middle income countries, although their PPG debt is about a third higher than their PNG debt, in terms of debt servicing, the majority of debt servicing occurs on PNG debt, roughly a third greater than that spent on servicing their PPG debts.

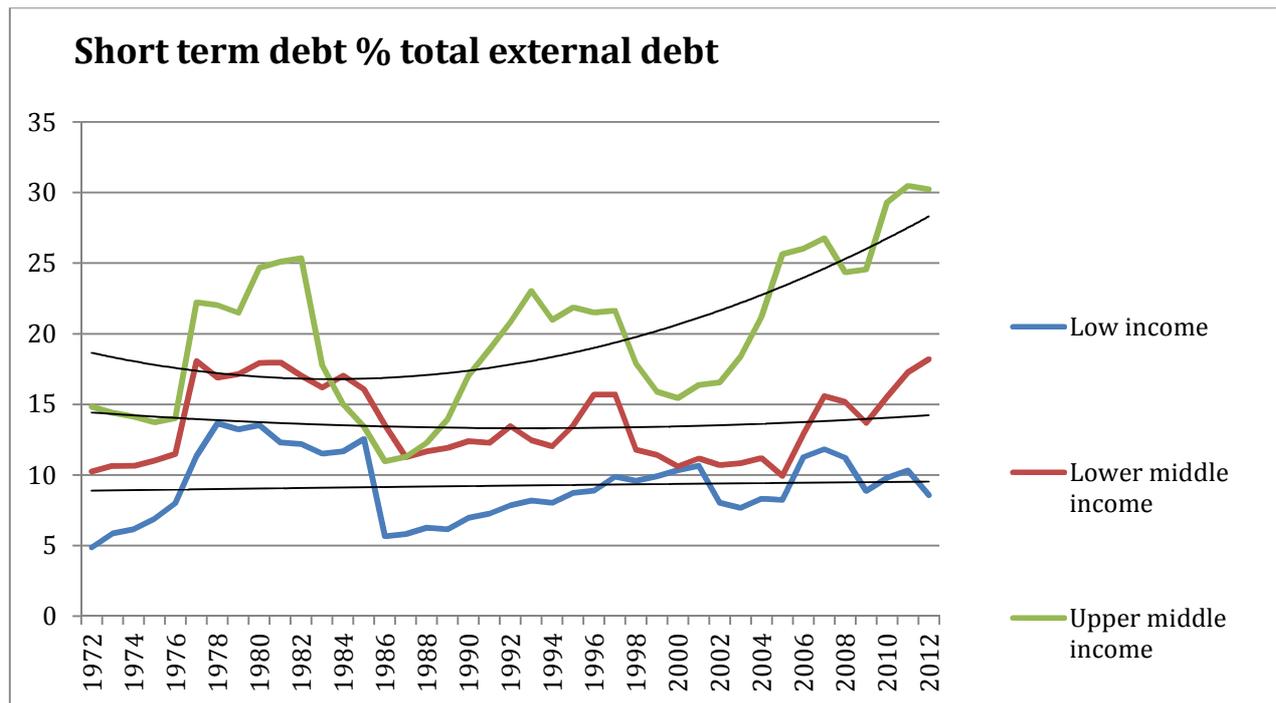


Despite huge variation in scale, all income groups witness a rapid accumulation of reserves, which can assist country's repayment of external debt. In the case of upper middle income countries, the figures are surely skewed by China, but on aggregate, all income groups are increasingly covering their external positions by maintaining high reserves.

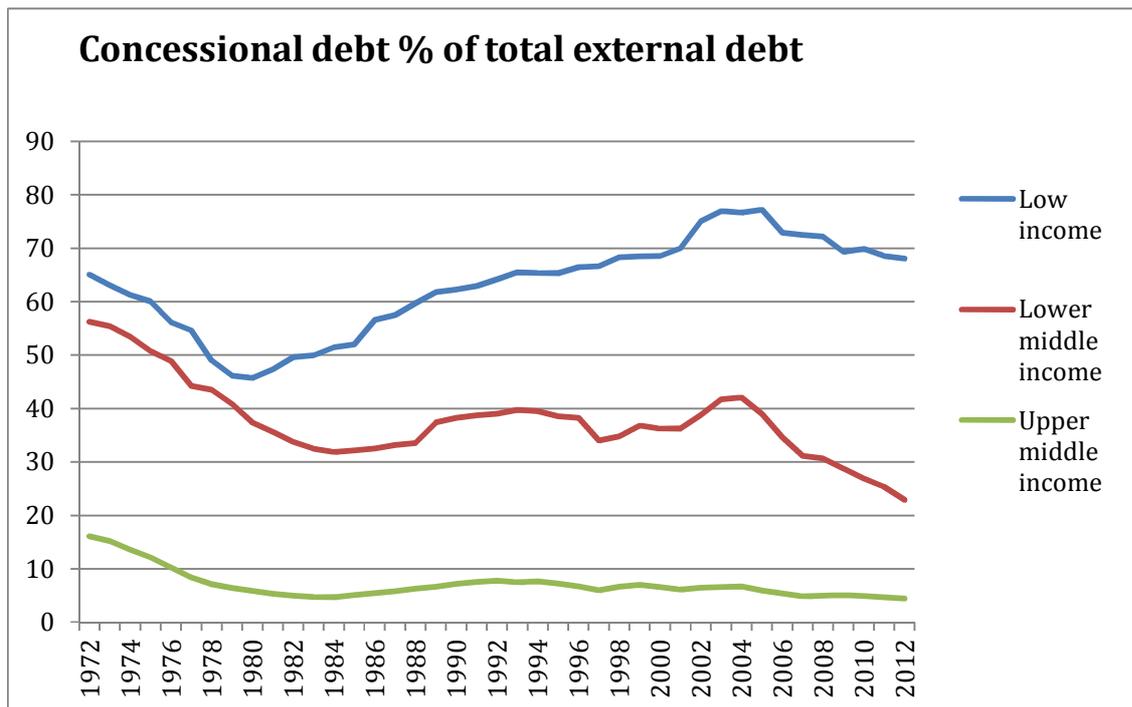
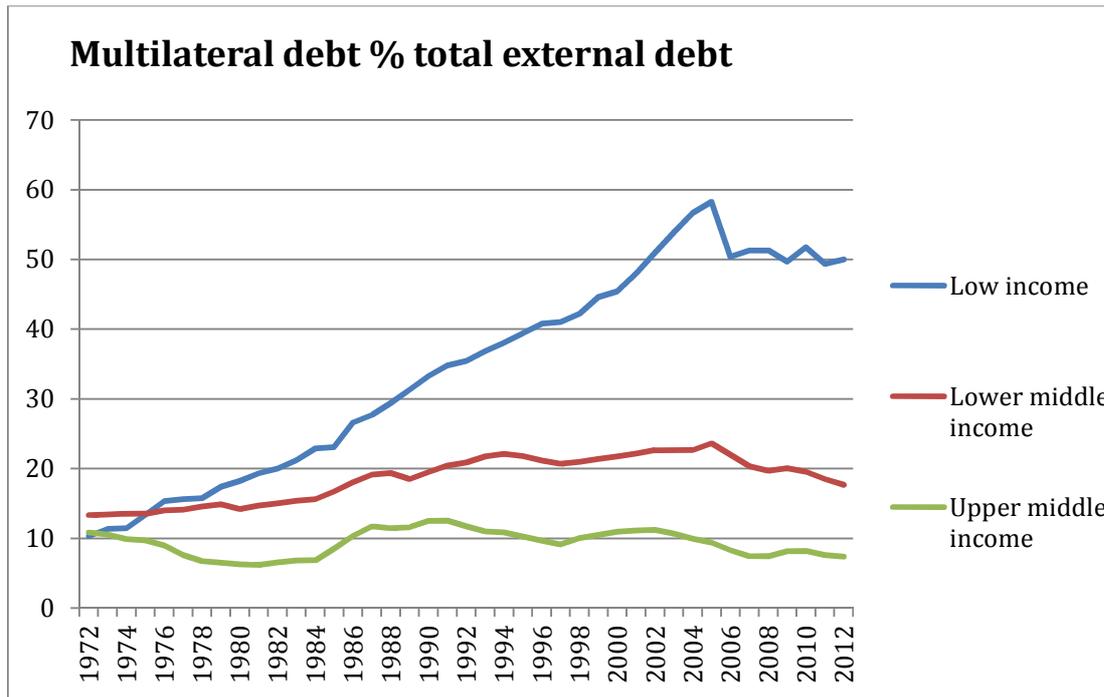


1.7.1 Maturity structure of external debt

The proportion of short term debt in total external debt also has clear differentiations amongst the income groups. Low income countries have the lowest proportion of external debt in short term maturities, at approximately under 10% since 1972. For lower middle income countries this has trended at under 15%, with a rapid rise in short term debt since 2005. For upper middle income countries, there is an increasing proportion of short term debt in total external debt, rising sharply since 2001, from over 15% to over 30%.

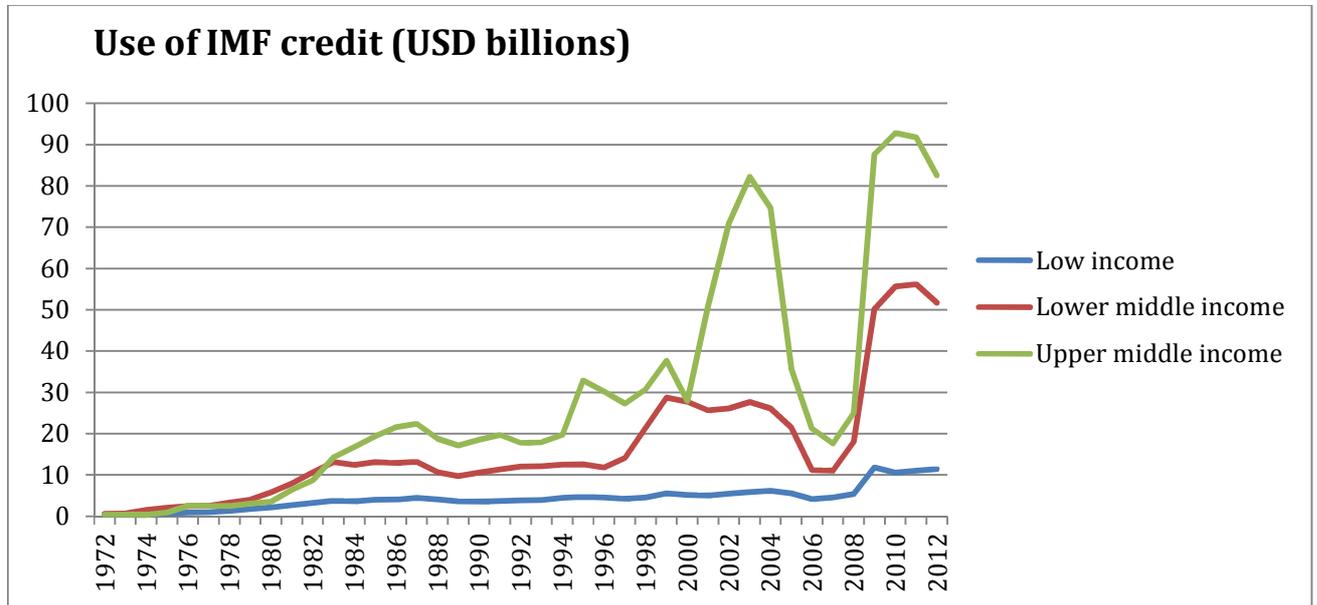


What is noticeable, if not unexpected, is that the low income group of countries have a significant reliance on multilateral debts, about 50% of the total, and approximately 70% of external debt being given on concessional terms.



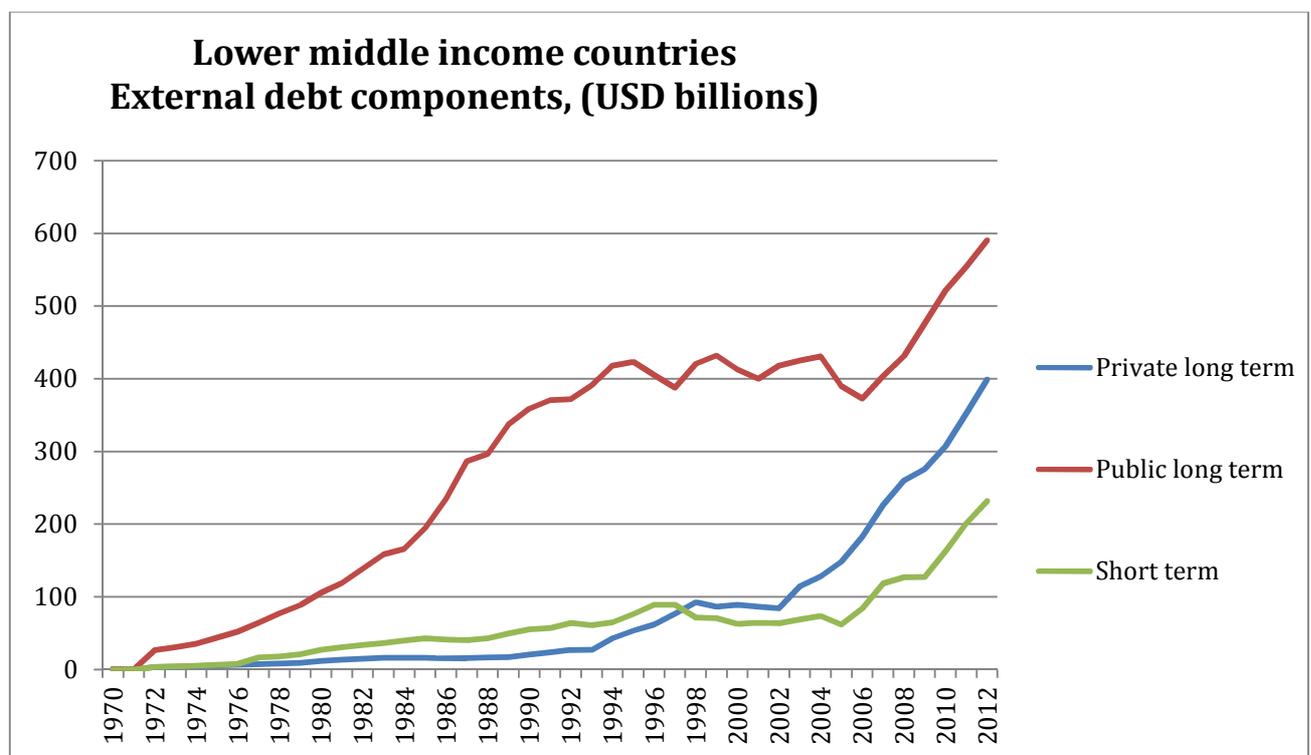
In absolute terms we can see that the richer the countries are the larger the loans they are receiving from the IMF. We can also see how in lower and upper middle income countries

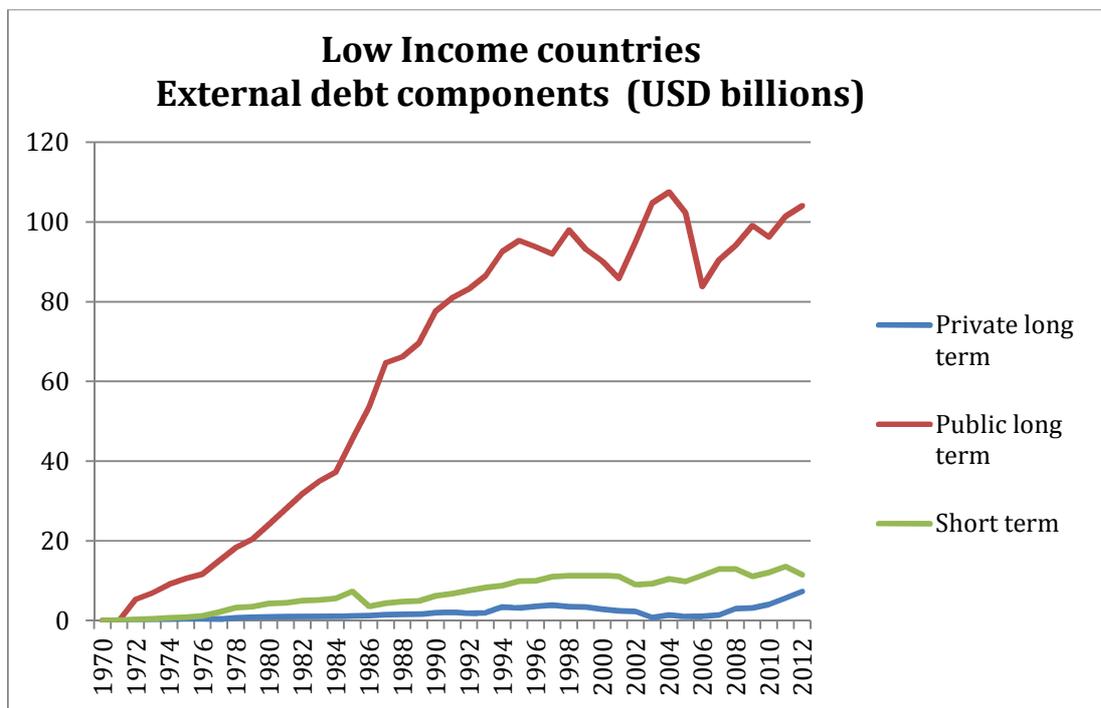
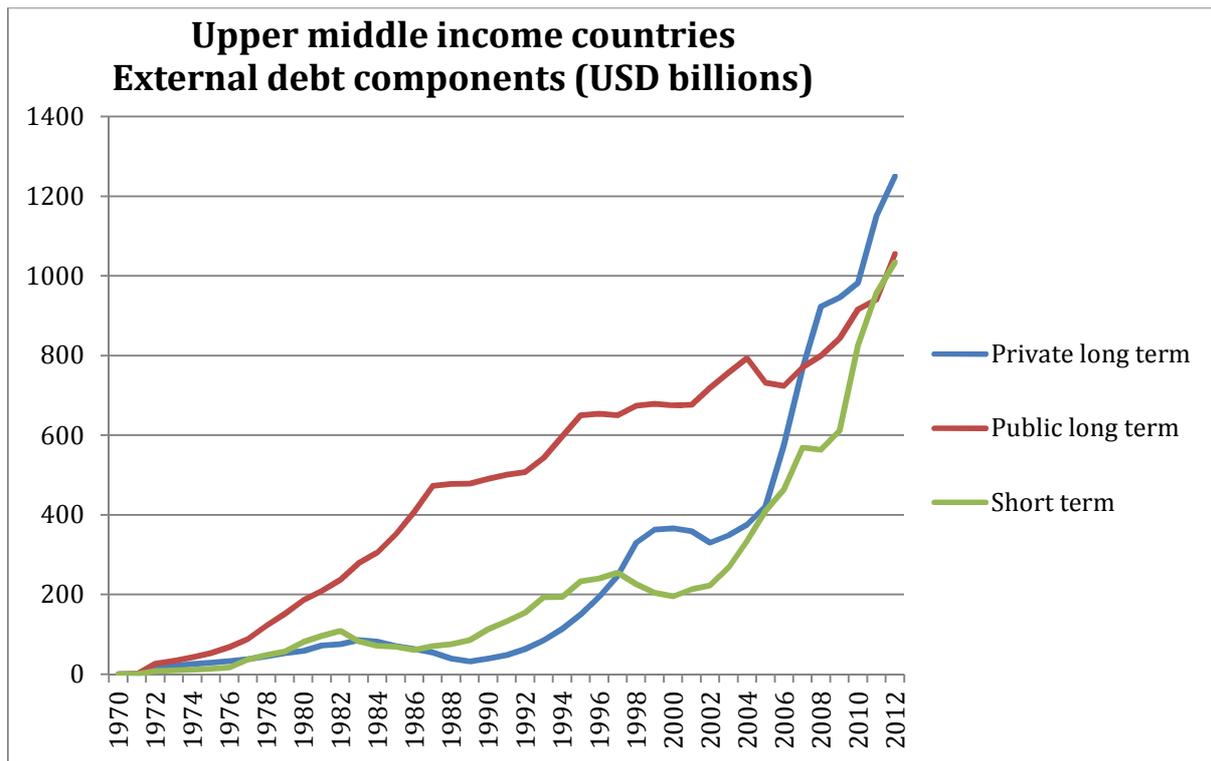
IMF credit has a more cyclical nature than in low income countries where IMF appears relatively stable over time.



1.8 Focusing on the growth of private sector external borrowing

One of the factors behind the rapid increase in developing countries' external debt is the increasing international borrowing by the private sectors of developing countries.

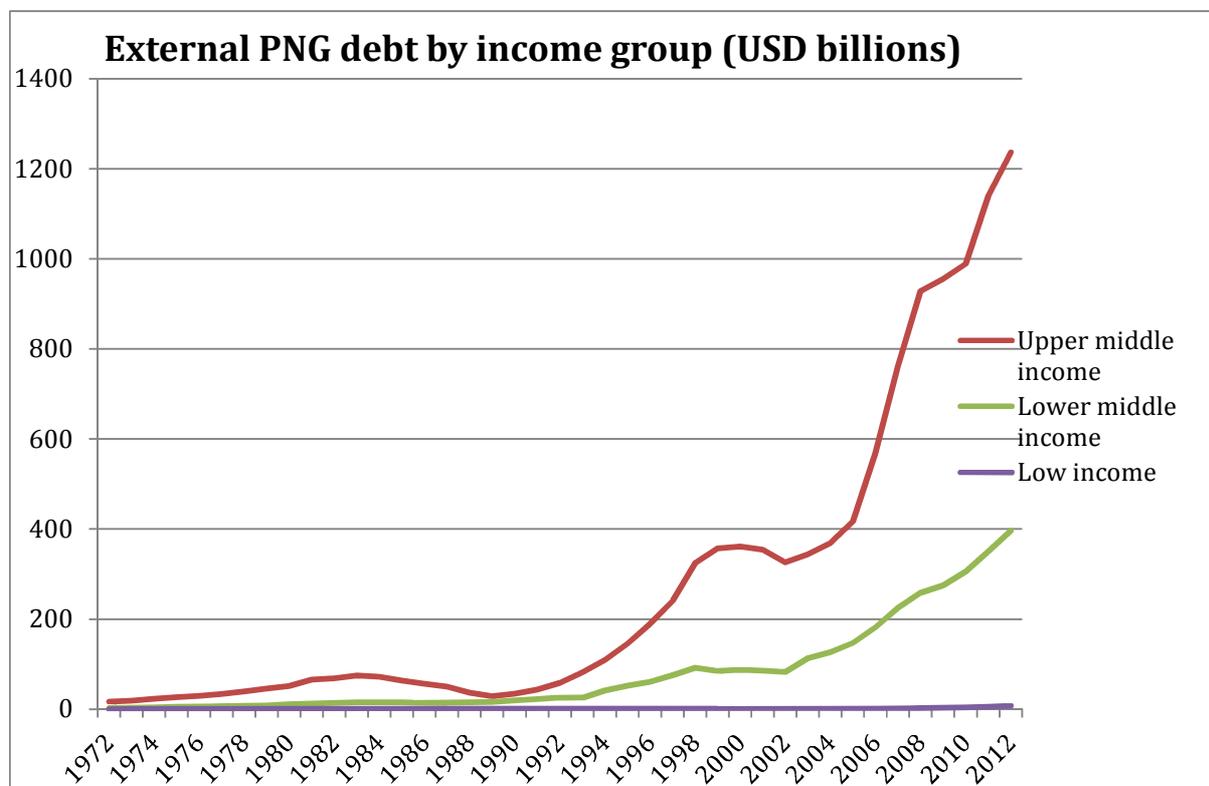




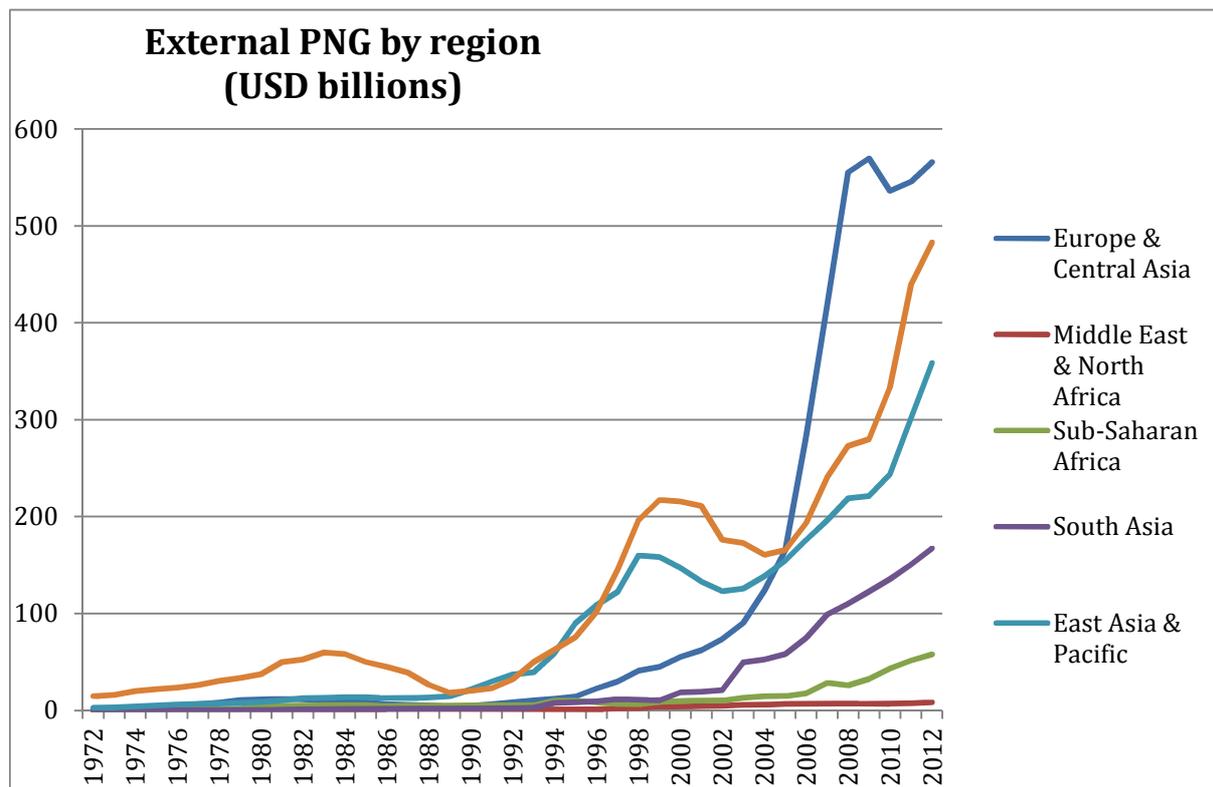
1.8.1 Private Non-Guaranteed debt

In this section we focus on the accumulation of private non-guaranteed (PNG) debt in developing countries, as we find the accumulation of these debts are crucial determinants of a country, or region's financial stability. Overall, out of 125 developing countries listed in the World Bank IDS database, there is no data for 42%, i.e. 53 of them. For the latest year examined, 2012, six countries (Ghana, Guyana, Kenya, Maldives, Niger, Sudan) which used to have external PNG debt in the past, no longer, and so are included in the 42%.

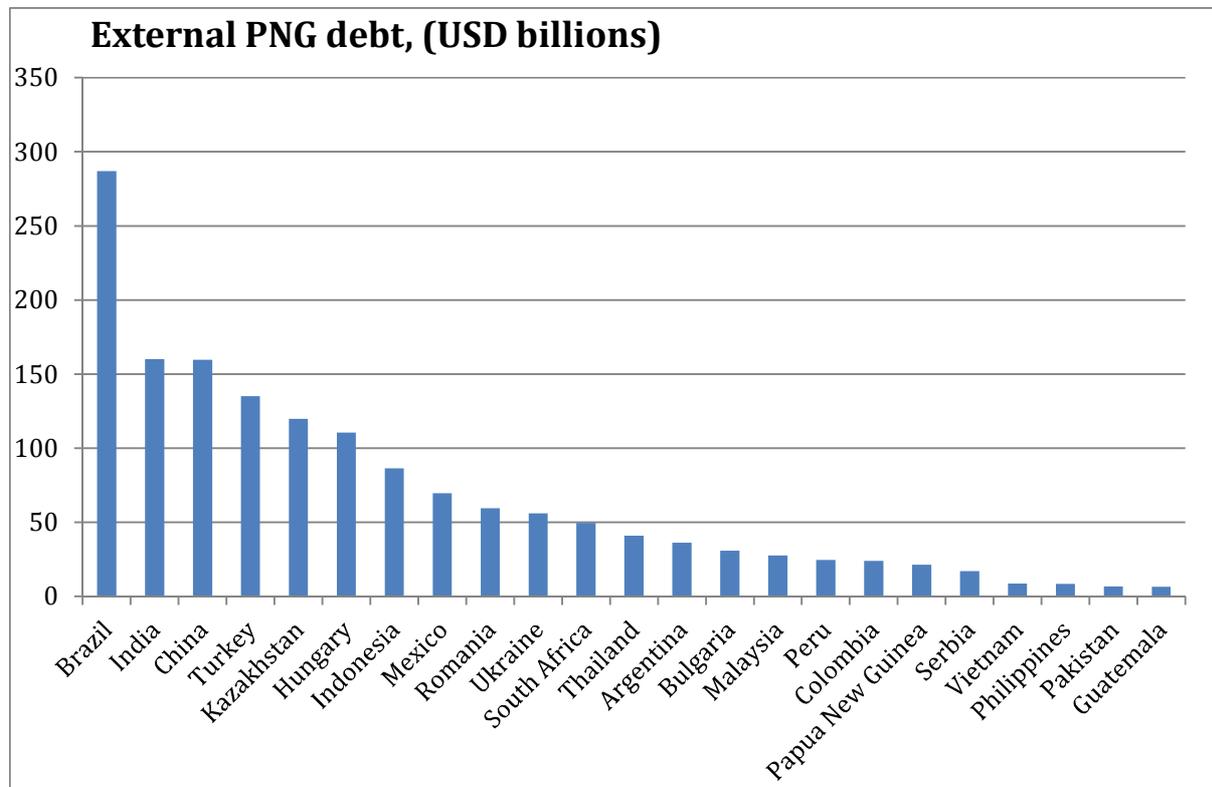
PNG debt is highly concentrated in upper middle income developing countries, amounting to over \$1.2 trillion and lower middle income countries attracting a third of this, at approximately \$400 billion. Low income countries attract close to zero PNG debts.



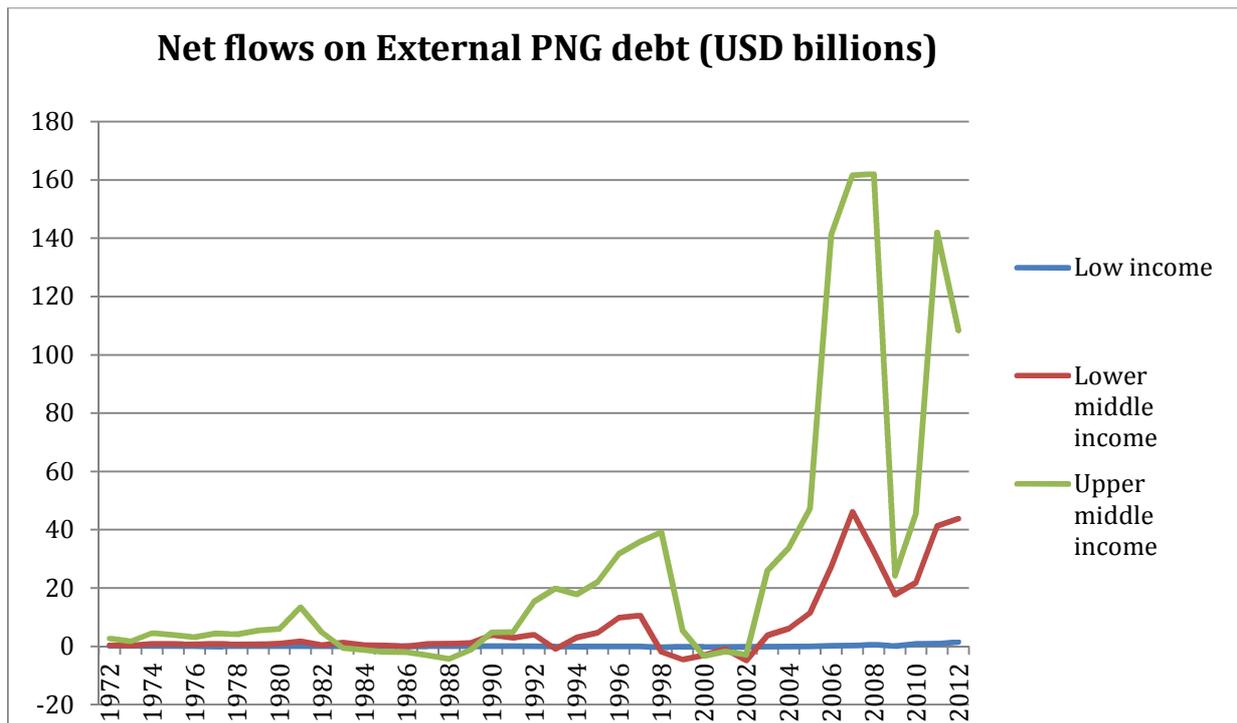
When looked at regionally, we can see in the figure below that ECA, LAC and EAP are the regions attracting the highest PNG levels, followed South Asia. SSA and MENA regions do not attract much external PNG debt. The rate of growth of PNG debt has been rapid, particularly since 2003 onwards.



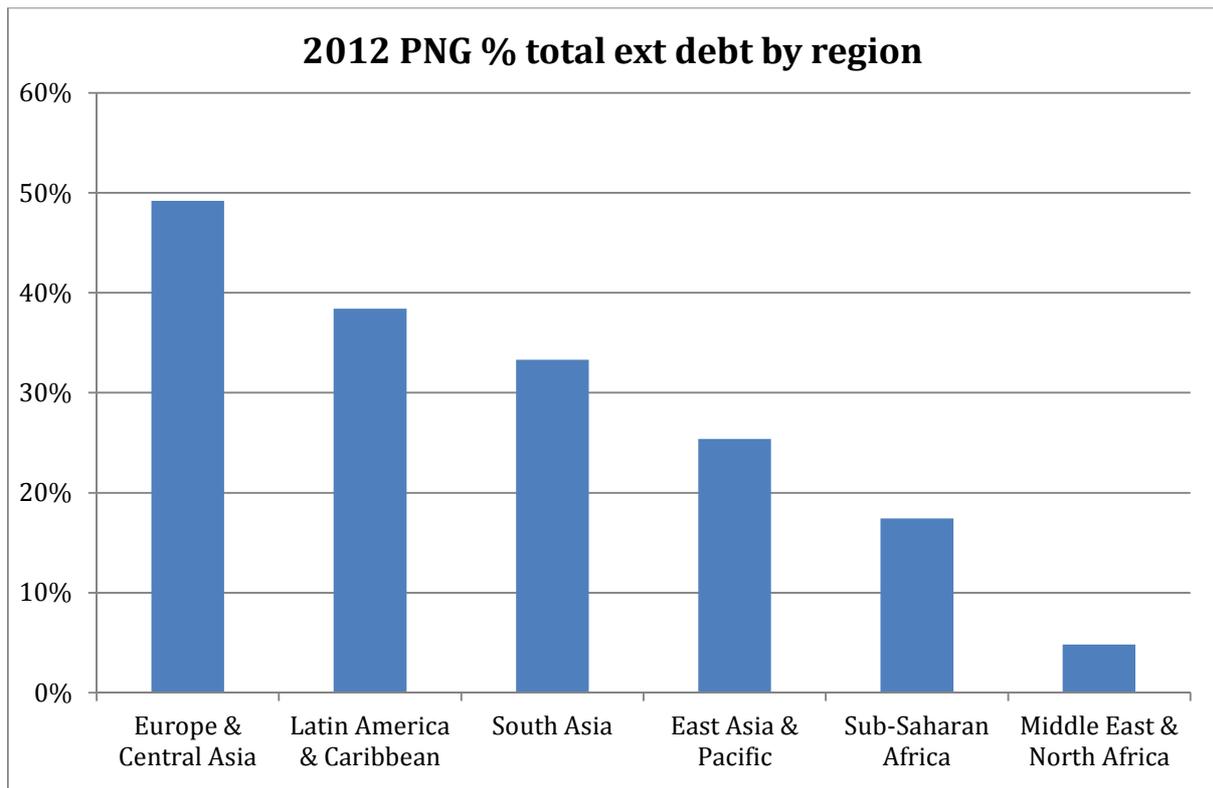
We ranked the size of PNG debt in absolute terms and in descending order. We found there to be massive variation in the top 20 countries, ranging from upwards of 300 billion in external PNG to under 10 in the 20th by size. This confirms that the accumulation of PNG debt is concentrated in a few destinations. The top ten are Brazil, India, China, Turkey, Kazakhstan, Hungary, Indonesia, Mexico, Romania, Ukraine. Five of these countries are in the ECA region, two in LAC, one in SA, and two in EAP. The following ten countries have external PNG debts under \$50 billion.



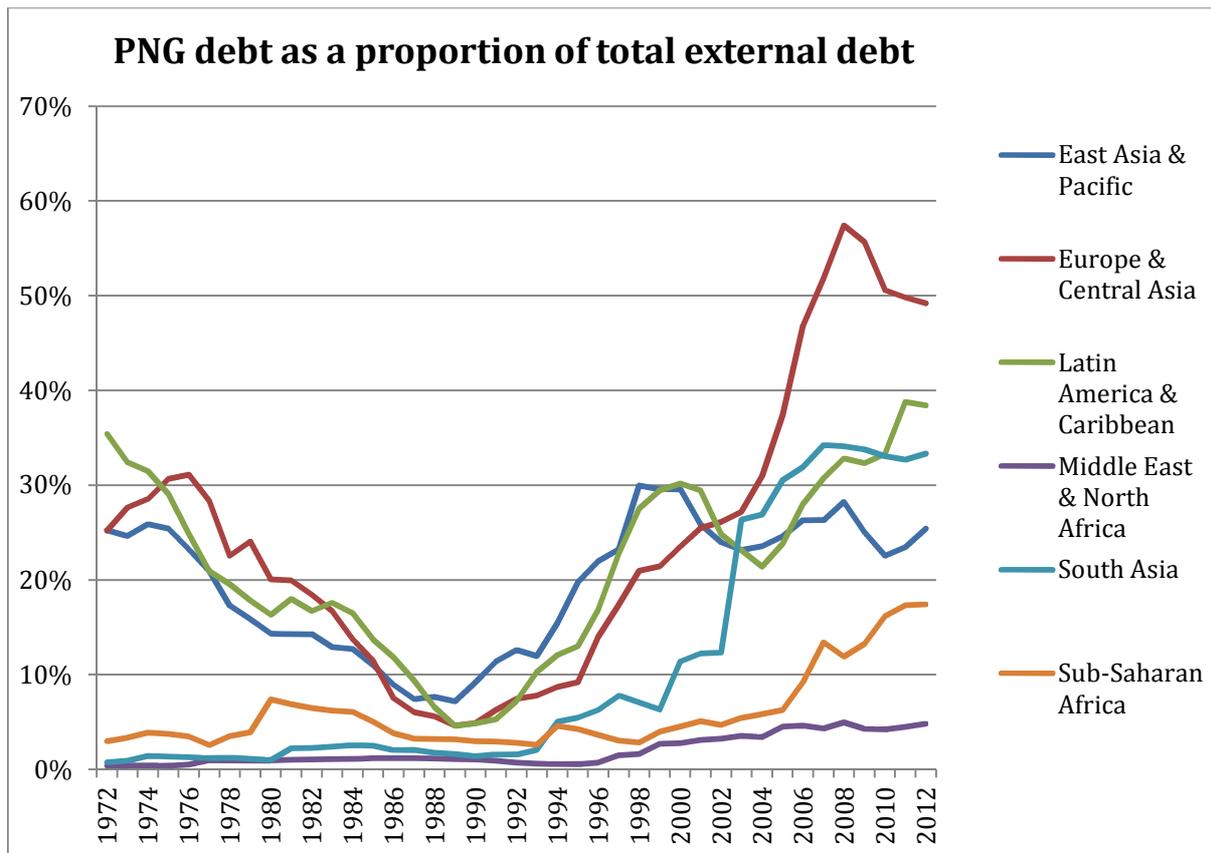
In order to assess future problems that changes in these debts may cause to a country or region's stability we look at the proportion of PNG in the country or region's total external debt. A county or region that is more dependent on PNG debts indicates that on the one hand they have access to international financial markets, and are an investment destination for institutional investors. From lessons from the past, it also indicates the potential instability of these flows that have characterised the legacy of financial globalisation. The fluctuations in net flows on PNG debts, as seen in the graph below, are significant and could potentially indicate problems in future financing needs, were these changes to be unpredictable.



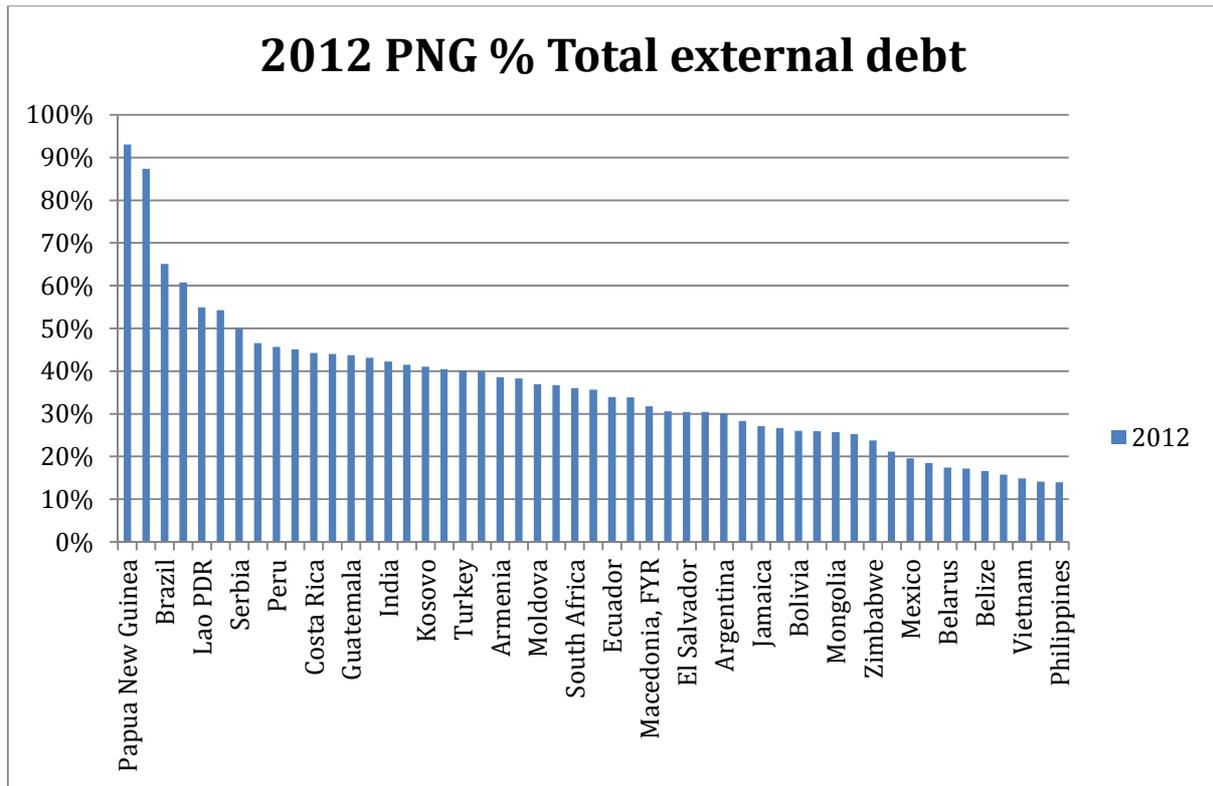
Although in absolute terms, upper middle income countries are substantially more exposed to PNG debts, when looked at in proportion to the total external debt, lower middle income countries are similarly dependant and thus vulnerable to changes in external PNG debts. In 2012 over 30% of external debt of lower middle income countries in 2012 was PNG, and over 35% of external debt of upper middle income countries in 2012 was PNG. For low income countries, PNG makes up 5% of their total external debt. Regionally, the relative importance of PNG in relation to total external debt closely mirrors the absolute sizes. ECA and LAC have the highest PNG debt both in absolute and relative terms to their external debt composition. The significant difference being that although EAP has almost double the quantity of PNG debt than South Asia, in relative terms, SA's PNG debt is a larger proportion of its total.



The trend of the relative importance of PNG debt in total external debt by region can be seen below.



Finally, if ranked by relative importance of PNG debt in relation to a country's total external debt, we find PNG makes up a significant proportion of external debt for Papua New Guinea, Kazakhstan, Brazil, Bulgaria, Laos, Hungary, Serbia, Uzbekistan, Peru, Romania and Costa Rica. For all of these countries for example, PNG debts make up over 40% of total external debt. Whereas the other big borrowers, such as China or Mexico it is under 20%. For Ukraine, and Turkey (also big borrowers) it is 40% and for South Africa and Indonesia it is between 30 – 40%.



2 Balance of payments - Current Account and Trade

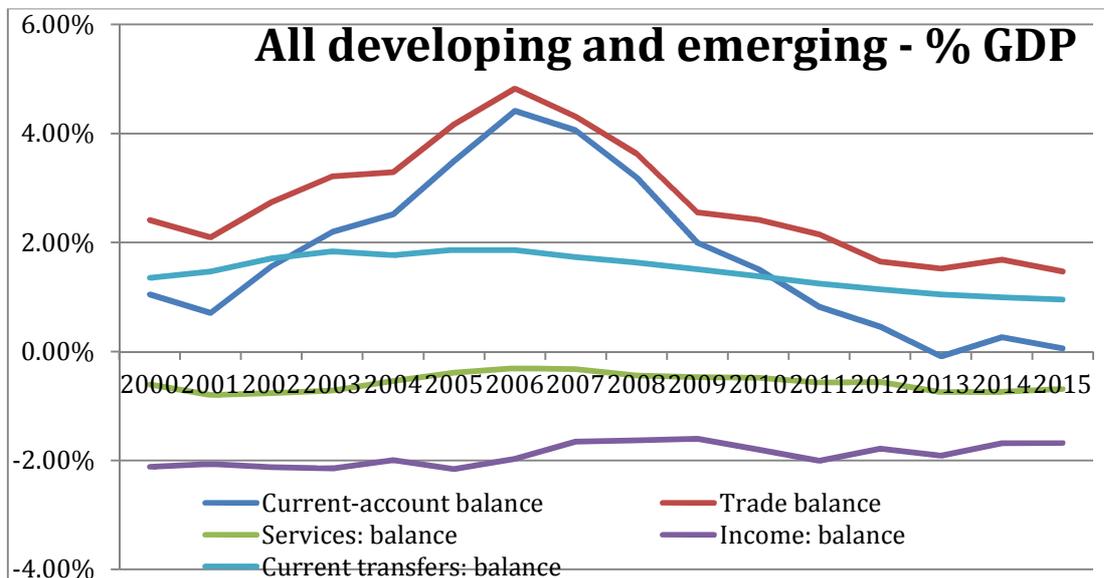
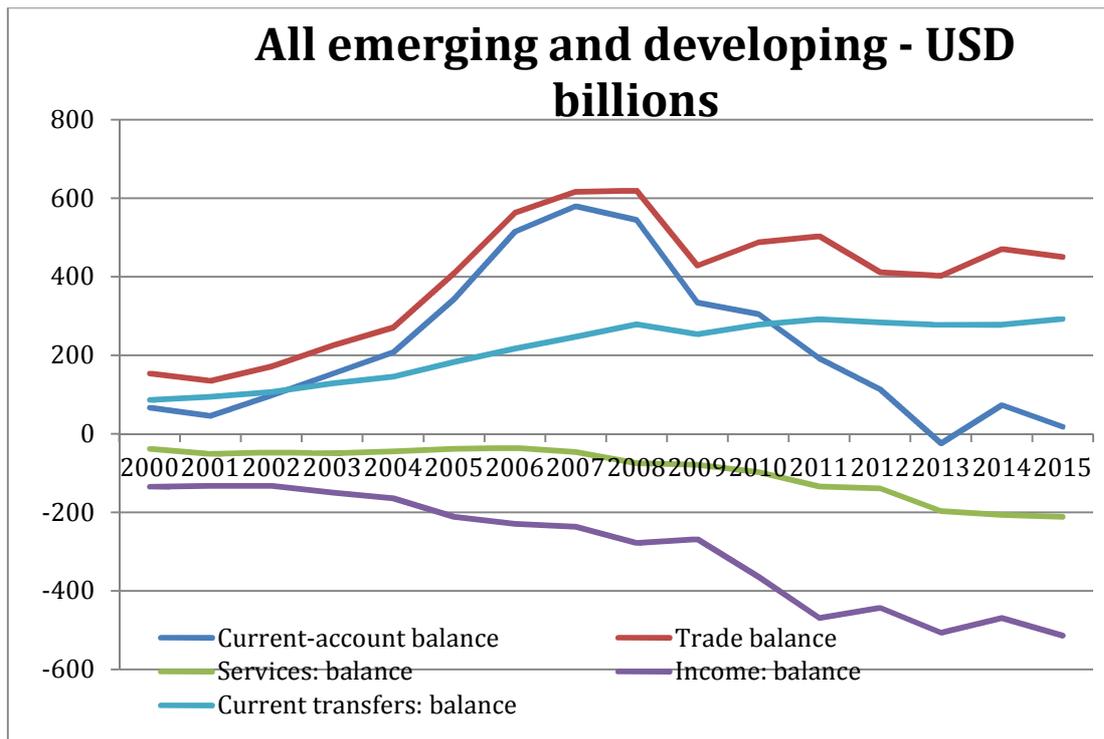
This section explores the evolution of the balance of payments of developing countries. This will include an overview on developing country current account positions and its components as well as a more detailed look at trade. These data will be presented for emerging and developing countries as a whole, and then for countries grouped by region and by income group.

Statistics come from a wide range of sources. Data for current accounts and its components come from UNCTAD for the aggregate figures and income groups, and from the Economist Intelligence Unit (EIU) for the regional statistics. The statistics considered include the current account overall positions, the trade balances of goods and services, and the net factor income balance. Where available with sufficient reliability and scope, figures for current transfers and remittances are also included.

Data from UN Comtrade can provide a more detailed look at the evolution of trade of developing countries, allowing disaggregation across the different components of trade as well as trading partners. The SITC classification was used to distinguish different types of goods. Commodity exports and manufacturing exports correspond to the SITC group 0,1,2, 3 and 4 while manufacturing refers to groups 5, 6, 7 and 8. In concrete terms commodities include agricultural and food products as well as raw materials of all kinds, while manufacturing products include all the remaining goods type (chemicals, machinery and manufactured goods).

It is important to point out that gross trade figures include trade within the considered countries (for example regional figures include intra-regional flows). However net figures refer to the external balance, since gross imports and exports within the group cancel each other out.

2.1 Emerging and developing countries – Overall picture



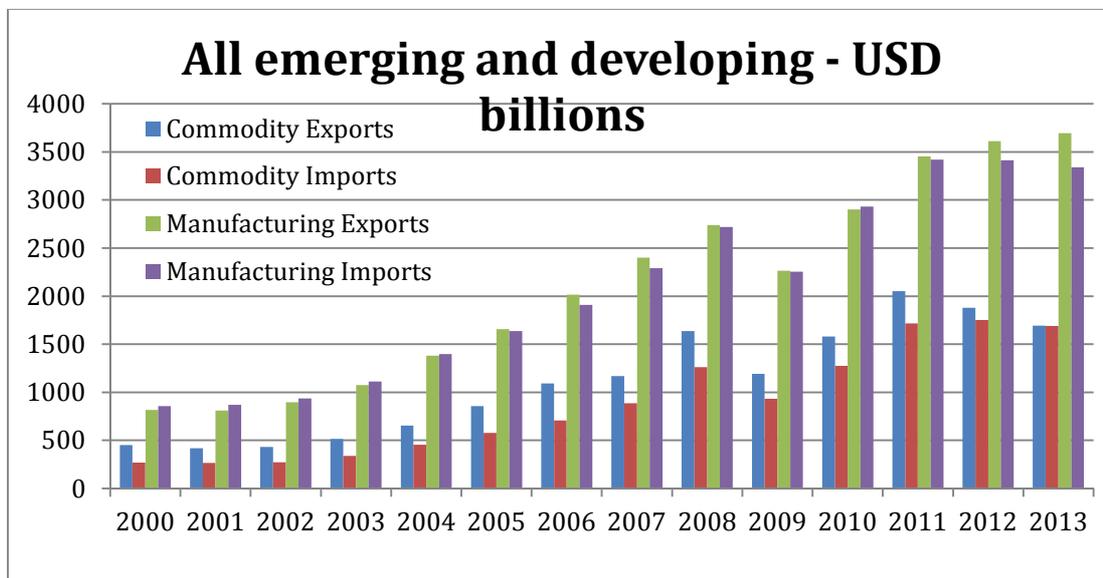
Source: Author's calculation based on Economist Intelligence Unit (EIU) Data

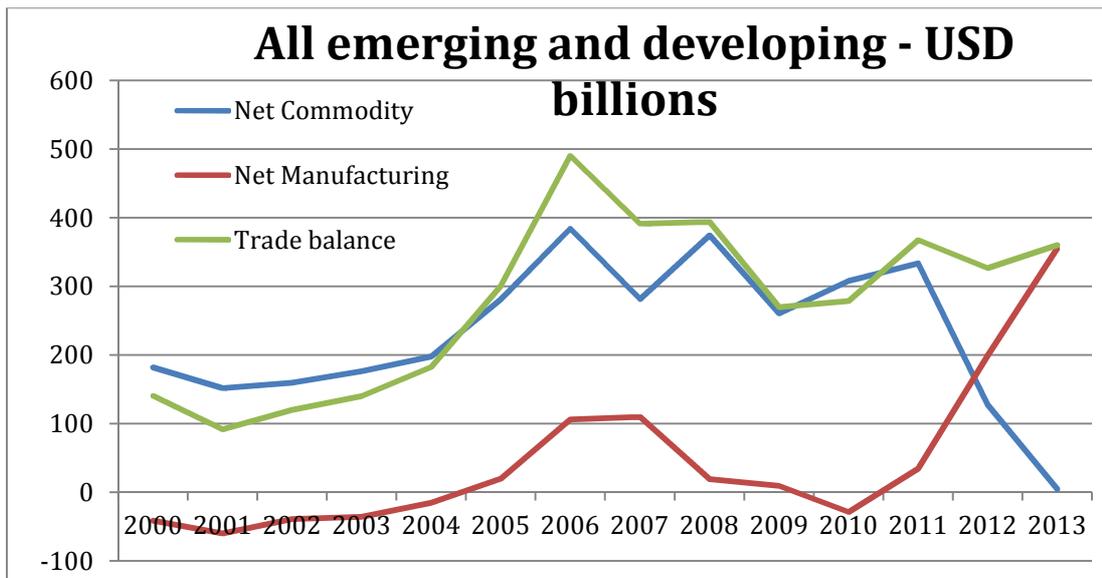
The figures above show the evolution of the current account and its components, in nominal US dollars units, and as a percentage of GDP. In both pictures the current account and the trade account follow very similar pattern, especially in the 2002-2009 period: they increase

remarkably, peaking in 2007, and then contract in 2008. However, after 2009 the two series seem to decouple, with the trade balance remaining stable in absolute terms and slightly declining as a percentage to GDP, whereas the current account deteriorated sharply both in absolute and relative terms, becoming negative in 2013. This seems to be due to a combination of declining transfers, deteriorating income account (in absolute terms) and the declining position in the trade of both good and services. The declining income balance matches our findings in Section 3, with debt service amounts by developing countries increasing steeply during the same time period.

Overall however, the position of emerging and developing economies seems to be much dependent on the global business cycle, mostly influencing their current account through changes in trade. The crisis has indeed brought a deterioration of the vast balance of payments surpluses, but their position remains roughly balanced even during the global recession. Indeed the EIU forecasts shown in the graph show a stabilisation around a small surplus in absolute and percentage to GDP terms.

2.1.1 Trade



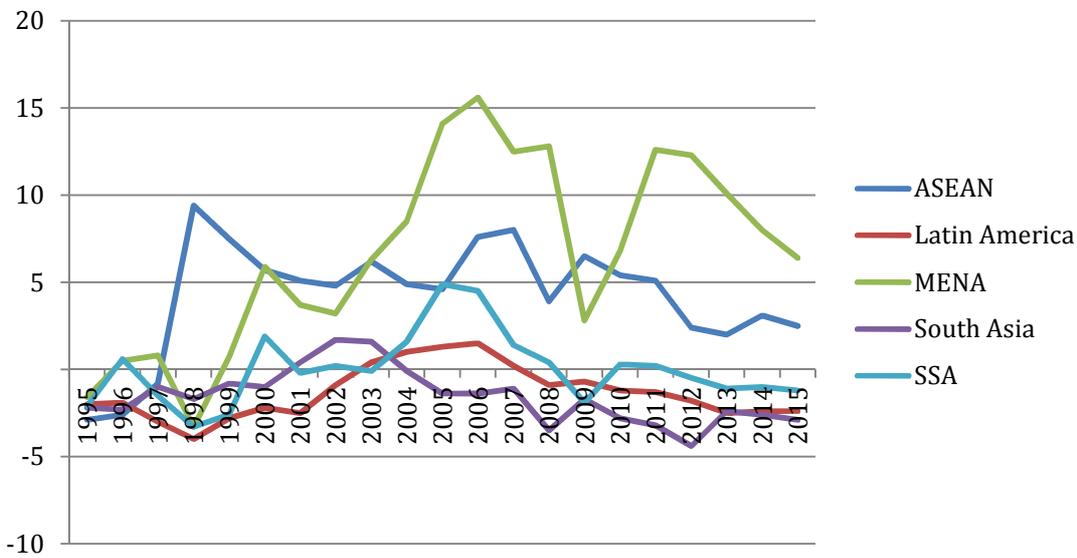


The trade breakdown into commodities shows that, on the one hand manufacturing is the most important part of emerging and developing countries' exports and imports, which are roughly twice the value of commodities trade over the whole period. On the other hand, while trade in manufacturing presents a roughly balanced account, the overall trade surplus has been mostly driven by a surplus in commodities trade. A puzzling finding is the evolution in the past two or three years, when the commodity trade balance dropped sharply while the manufacturing surplus increased equally sharply, leaving the trade balance almost unchanged. The data shows how this is the result of a decline of commodity exports and manufacturing imports, while manufacturing exports kept increasing. This finding deserves further analysis.

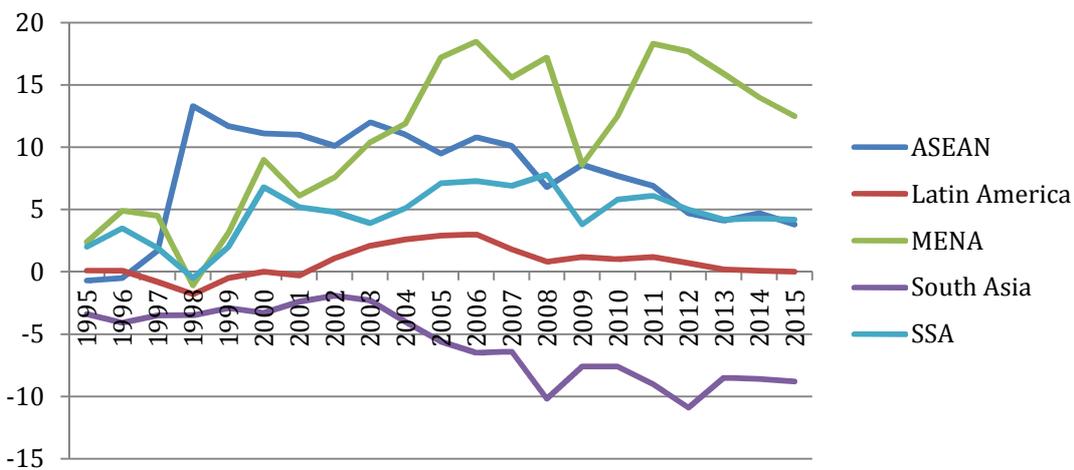
2.2 Regional classification

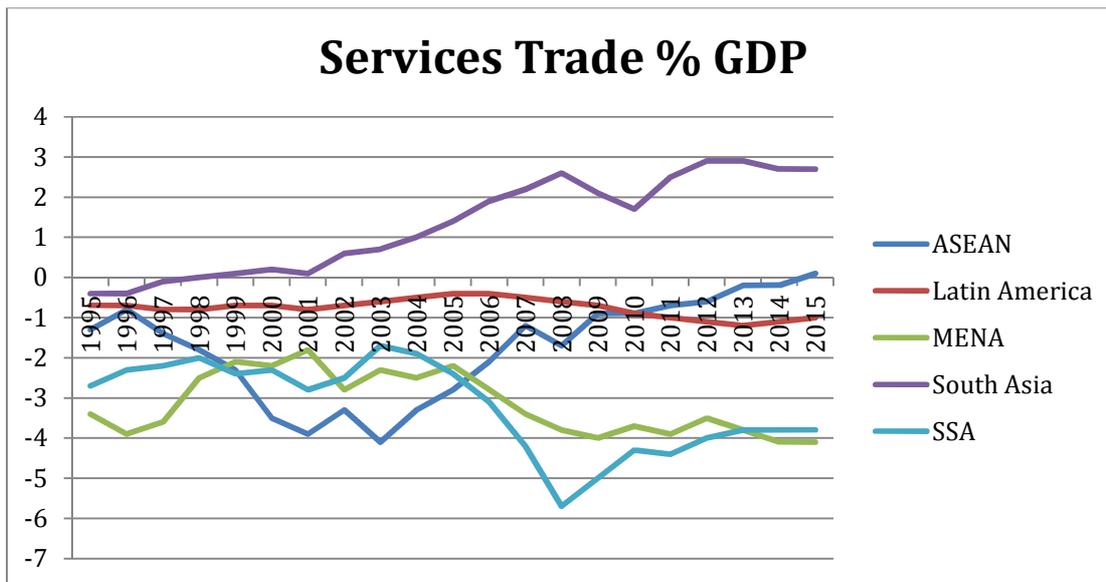
2.2.1 Current accounts

Current Account % GDP



Trade in goods % GDP





As the following charts show, the current account surpluses were common across the ASEAN and the MENA countries, but with significant surpluses at times in Latin America and Sub-Saharan Africa. The only exception is South Asia, which experienced a deteriorating current account since 2002. Since 2008 however the trend seems to have reverted, with all regions current account balance decreasing and becoming negative.

Overall the goods trade account shows a very similar picture: all regions, except South Asia, had a more or less constant surplus in the 2002-2008 but these have decreased since the onset of the crisis. The figures further show that the considerable size and variability of such surpluses, ranging between 2% and 15% in the 2007 pre-crisis peak.

Conversely, all regions experienced deficits in all their services trade accounts over the whole period. Once again South Asia is an exception, with a surplus growing over the whole period, reaching about 3% in 2012.

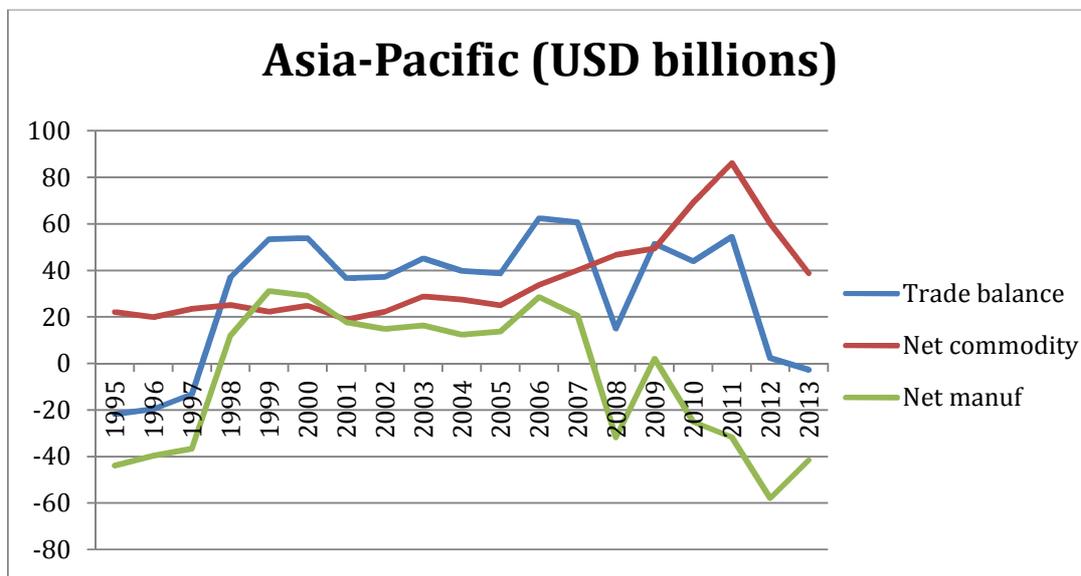
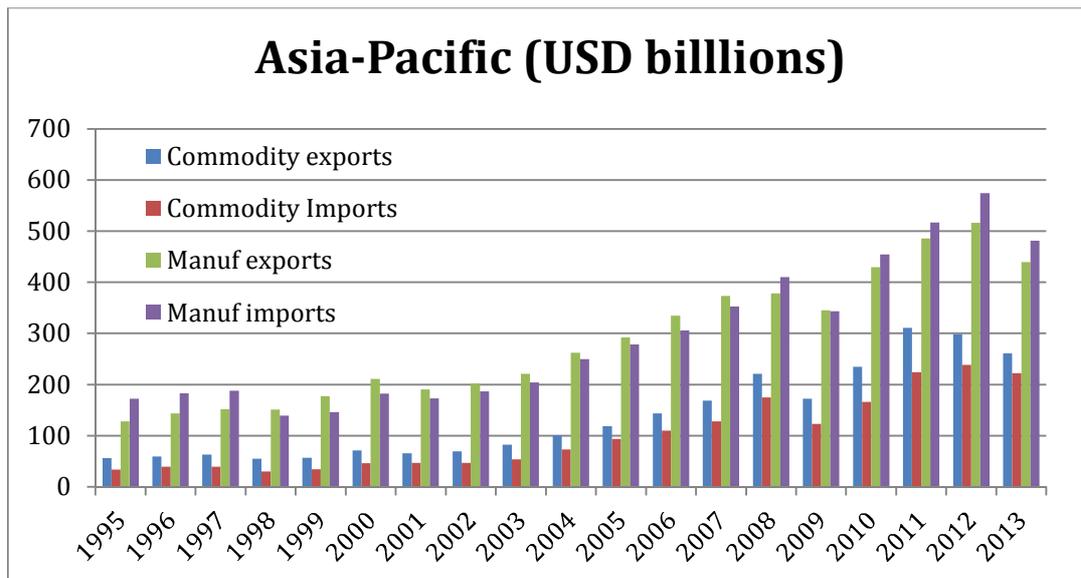
workers' remittances. The global financial crisis, unlike the trade figures, does not seem to have a clear-cut effect on income flows.

Current transfers are unsurprisingly positive for all regions, except the MENA countries. This latter finding most likely reflects the inclusion of richer oil-exporting countries in the group, such as the Emirates, Kuwait, and Qatar, which are not targets of Aid and official assistance flows.

Overall the figures show how most regions have not been especially vulnerable externally in terms of their overall current account balance. The evolution of their current accounts, which follows quite closely that of the trade in goods accounts, presented positive figures until 2008, the only exception being South Asia, whose services trade surplus did not compensate the growing trade in goods deficits. However, all regions suffered from the 2008 crisis: the deterioration of trade and current accounts since then has been slow but steady.

The other components confirm essentially the developing/emerging country nature of the countries considered: they are net interest and dividend payers to foreign countries, and net receivers of foreign transfers. This is a more structural condition, and the figures do not indicate any imminent change.

2.2.2 Trade

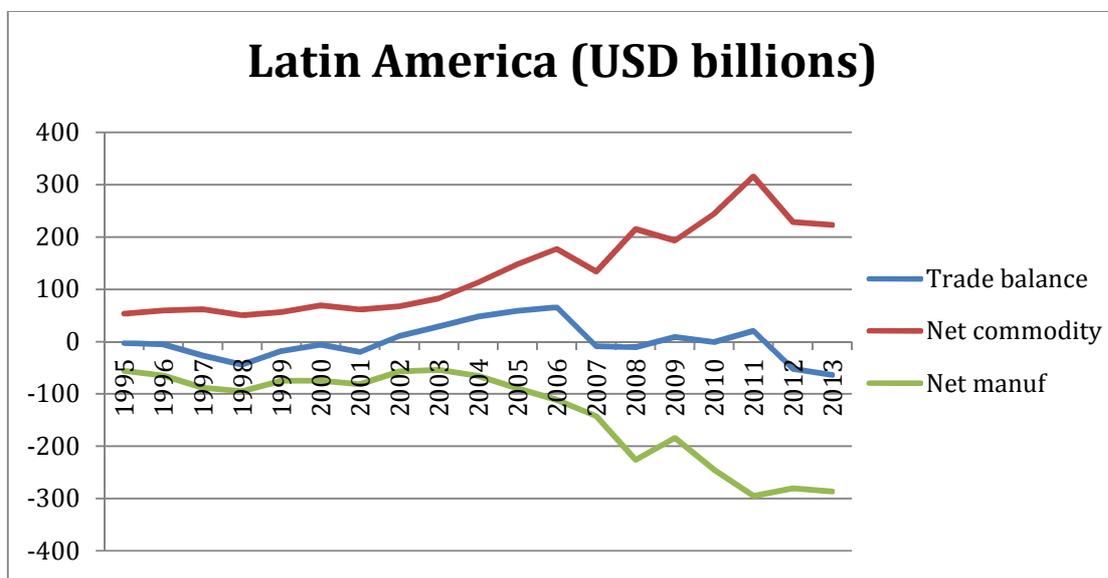
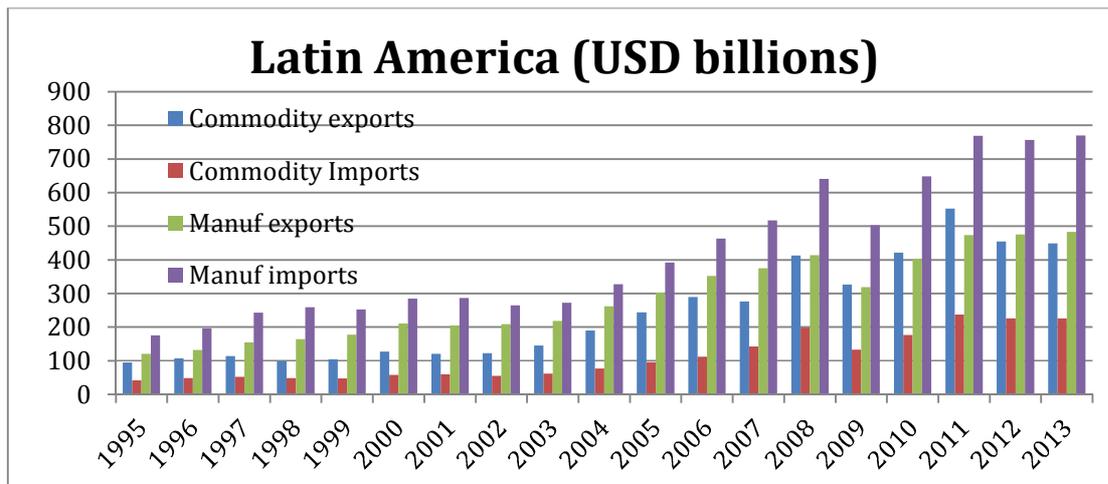


Source: Author's calculation, data from UN Comtrade through WITS

External trade of the middle and low-income Asia-Pacific⁹ countries is mainly in the form of manufacturing products. Manufacturing in 2013 constituted about 63% of exports and 68.5% of imports, although the proportion has decreased over the whole period from respectively 69.5% and 83.5%.

⁹ Asia-Pacific countries do not include China, to ensure consistency with the ASEAN classification used above for the current account statistics. Figures for China are explored separately.

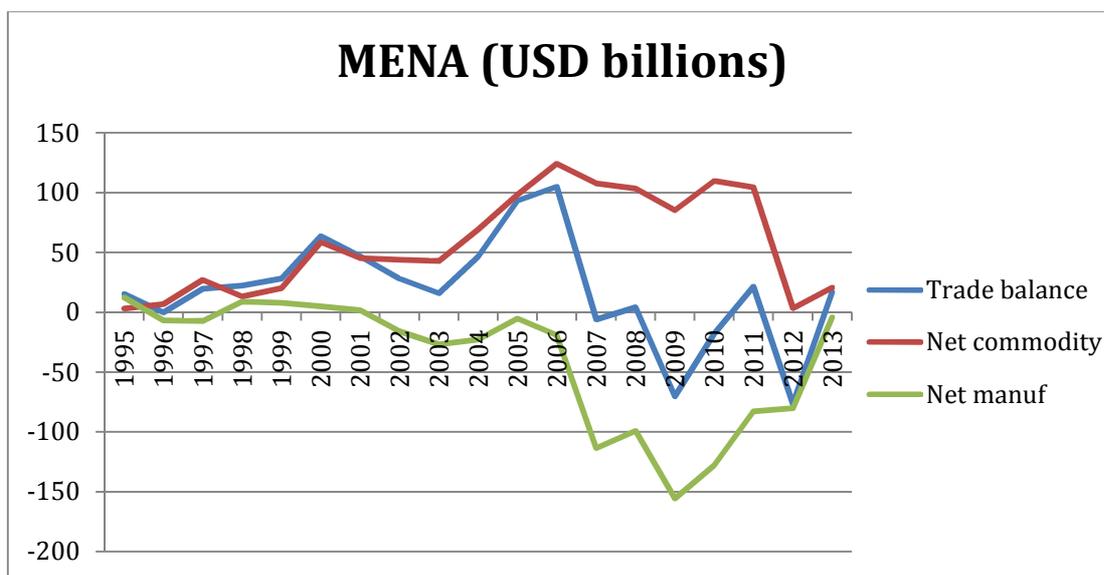
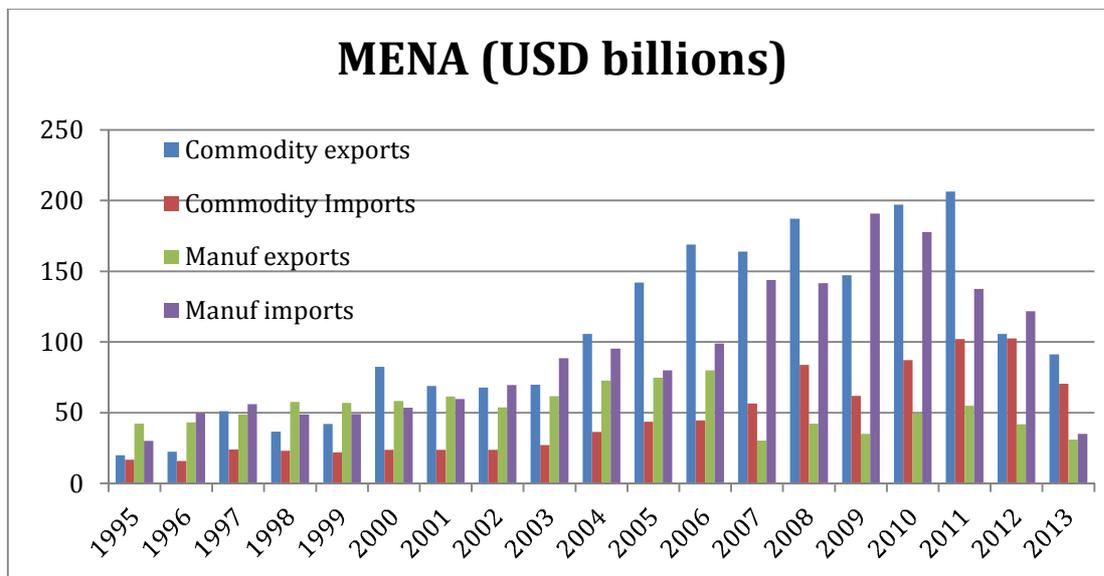
Consequently, the overall trade balance looks closely related to the dynamics of manufacturing trade. In the 1998-2008 period both net manufacturing and commodity exports showed surpluses. However since the global financial crisis the manufacturing trade account has become negative, as imports bounced back from the 2009 low faster than exports. The deterioration of the manufacturing balance has brought about a deterioration of the overall trade account.



Source: Author's calculation, data from UN Comtrade through WITS

The experience of Latin America has been similar although more influenced by the evolution of commodity trade. Traditionally within Latin American countries there have been major commodity exporters, and this is reflected in the higher proportion of commodity to total

exports over the whole period, starting from 44% in 1995. This has however remarkably grown over-time, reaching a peak of 53% in 2011, and slightly decreasing since. At the same time, imports have remained a minor fraction ranging between 19% and 23% of the total. The higher impact of commodities is reflected in the evolution of trade balances. The 2002-2006 trade surpluses came with a boom in the commodity trade surplus. However since 2007, the trade account has remained more or less constant in a balanced position, and turned negative in very recent years, following a decrease in the commodity trade surplus. Remarkably the evolution of the commodity trade account is mirrored by an opposite evolution of the manufacturing trade, which has deteriorated considerably since 2002, and the resulting deficit has now grown bigger than the surplus in commodities.

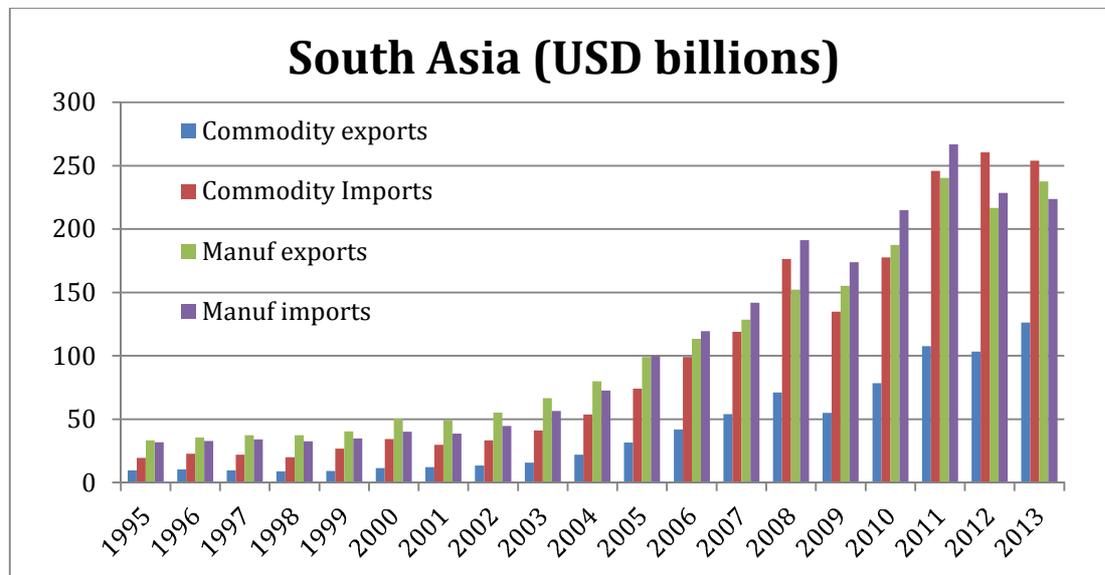


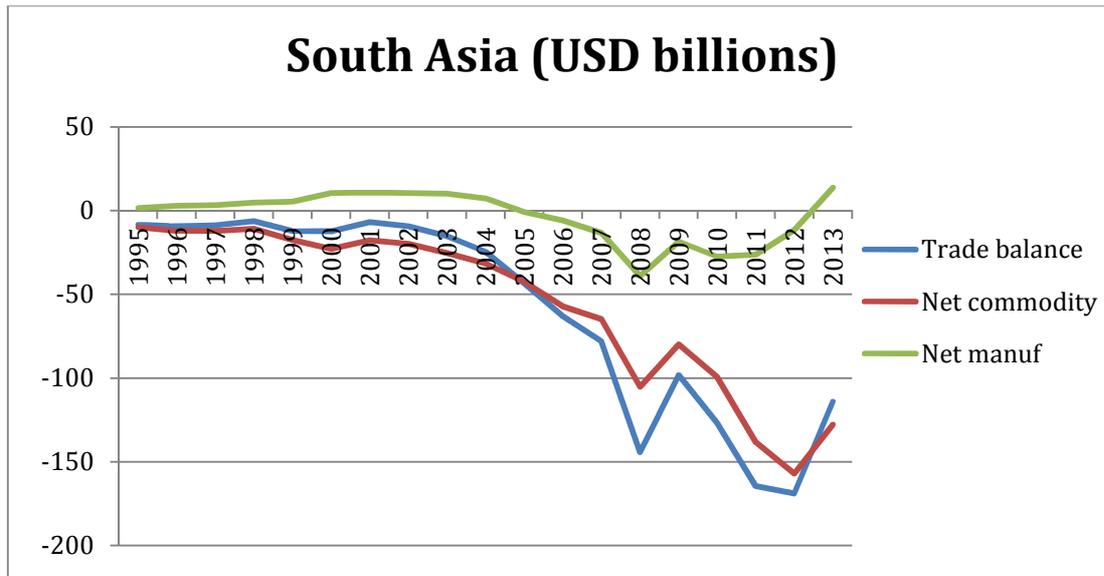
Source: Author's calculation, data from UN Comtrade through WITS

International trade by countries in the MENA region is characterised by an even more unbalanced focus on commodity trade. The share of commodity exports to total exports more than doubled between 1995 and 2009 from 32% to about 81%, while imports remained more stable, oscillating between 28% and 36% over the same period.

Similarly to Latin America, the trade account follows quite closely the boom in commodity trade surplus in the decade before the global financial crisis. However, since 2006, the stabilisation of this surplus and the sharp deterioration of the trade in manufacturing balance resulted in a reduction of the overall trade balance, which has oscillated around a balanced position since 2008.

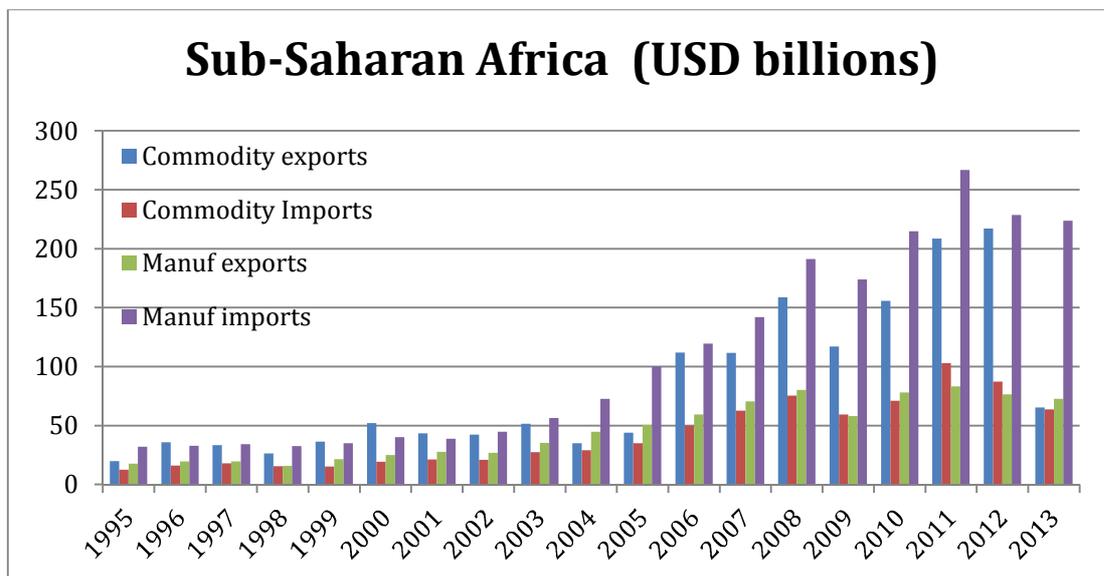
An additional noteworthy feature of the MENA region is that manufacturing exports shrunk abruptly in 2007, with commodity exports slowing down in 2011 with a the generalised slowdown in external trade since 2011 onwards, with imports and exports in both commodity and manufacturing declined. This is likely a consequence of the impact of the European crisis and Arab Spring on economic activity.

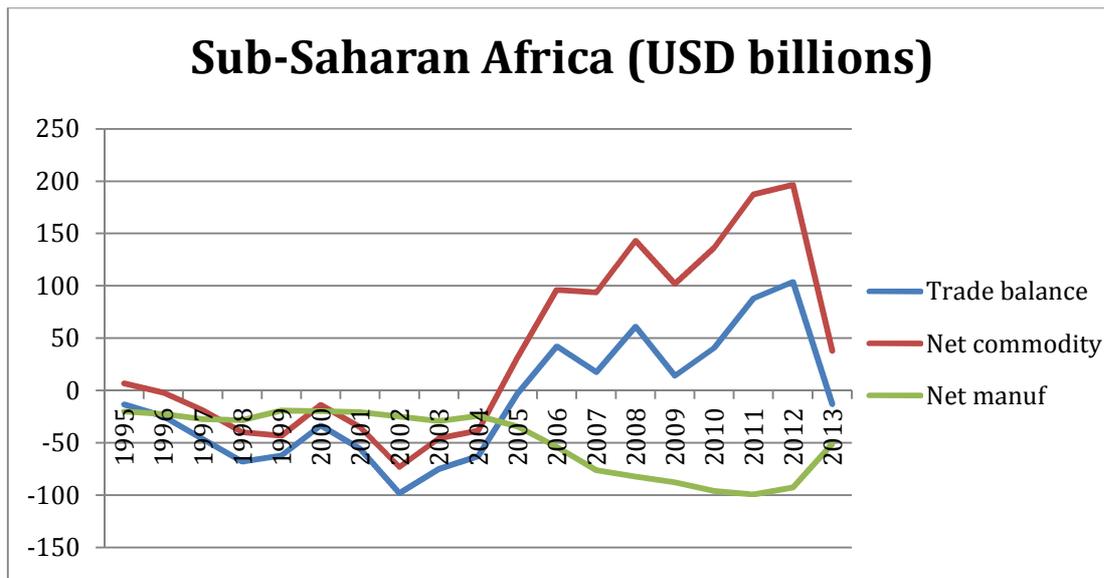




Source: Author's calculation, data from UN Comtrade through WITS

South Asia is the only region whose dynamics have been heavily dependent on commodity imports. The share of commodity exports has grown steadily from 22% in 1995, but remains at the lowest level across all developing regions at 35% in 2013. The weight of commodities in total imports is on the other hand much bigger, growing from 38% to 53% over the period. The impact of commodity imports is clearly reflected in the trade balance, which follows quite closely the rise in the deficit over the whole period. The balance of manufacturing trade has remained roughly balanced, with a small surplus before 2006 a small deficit since then, reversing again very recently in 2012 and 2013.





Source: Author's calculation, data from UN Comtrade through WITS

The experience of Sub-Saharan African (SSA) countries is similar to those of the MENA region. SSA exports are also very much commodity dependent, with the commodity exports share rising from 53% to 74% over the whole period¹⁰, with the share of imports remaining almost unchanged.

As a result the commodity trade balance has dramatically increased since 2004, and remains in a high surplus position after the crisis. At the same time the trade deficits in manufacturing has widened, but by less so than the surplus increase in commodity trade. The combination of these two resulted in an overall surplus position in the trade balance, which follows quite closely the dynamics of the commodity exports balance over the whole period.

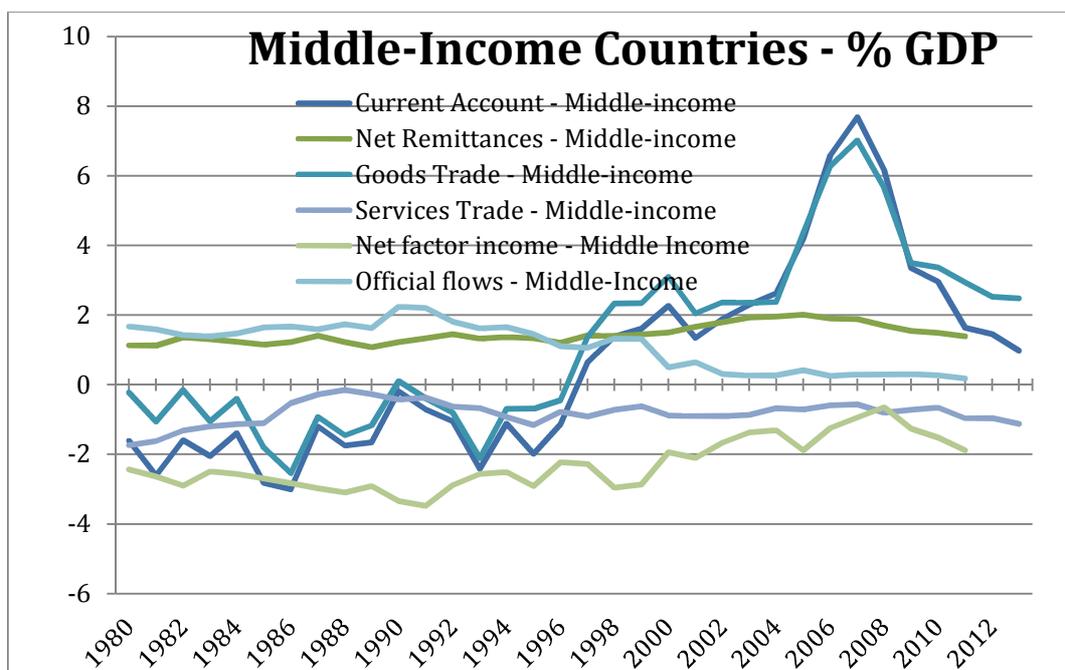
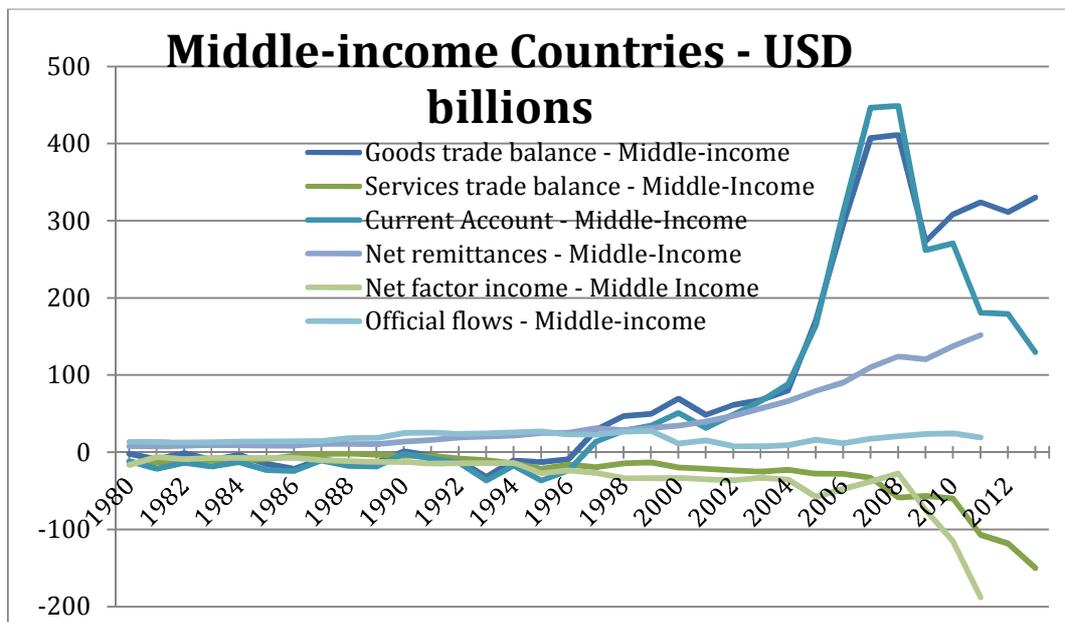
In sum, all regions except South Asia are net commodity exporters, with commodities constituting a growing majority of their exports. In all regions commodity trade surpluses have similarly increased in the decade before the crisis, and in the majority of cases remain positive, despite a sharp drop in exports after 2011. South Asia is a commodity importer but its trade accounts is mostly influenced by the dynamics of its commodity trade deficit. The

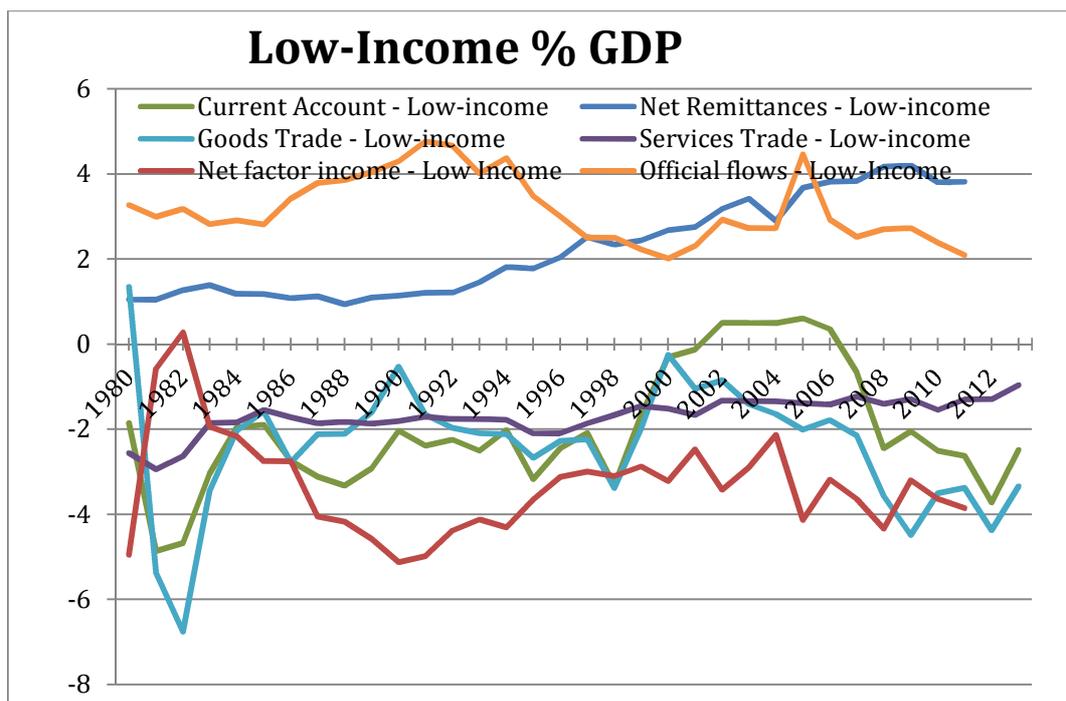
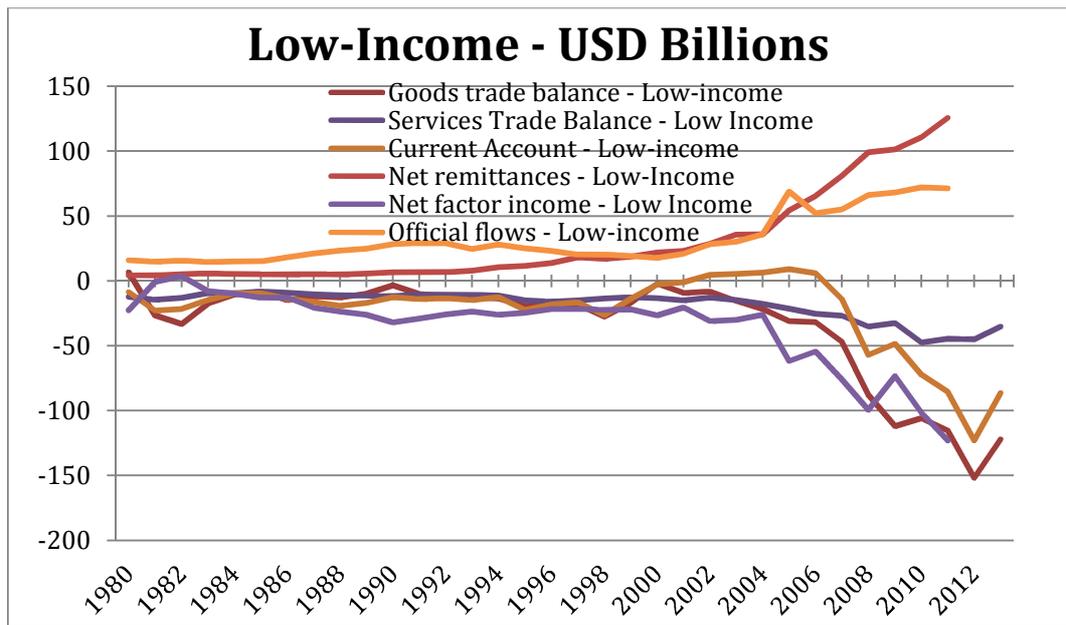
¹⁰ Until 2012, since the 2013 show an implausible huge drop in commodity exports. possibly reflecting incomplete data.

only region where manufacturing exports play a dominant role is the Asia-Pacific region, but since 2008, even in that region manufacturing trade has turned to a deficit position.

2.3 Income groups

2.3.1 Current Account





The general trends of current accounts and trade accounts are not much dissimilar to those discussed in the previous section. Current account positions largely follow the dynamics of the trade balances, which have improved since the late 90's especially in the 2002-2007 period. In general, trends for the middle-income countries look very similar to the figures for all emerging and developing countries, which again suggests their importance within the group.

The two groups however differ in some respects. Firstly, the size of the current account surplus and the associated trade surplus has been much larger and protracted in middle-income countries. As a proportion of GDP, middle-income countries show figures above 2% since 1998, touching 6% in 2007 and still remain above 1% after the crisis. On the other hand, in low-income countries, current accounts positions have been positive and below 1% only in the 2002-2007 period, when trade balances also improved, though remained negative.

Secondly, the deterioration of trade and current account balances after the crisis has been very sharp in both groups. However, while it turned the surpluses into deficits in low-income countries, which have ranged around -2.5% of GDP since 2009, in middle-income countries they are still experiencing current account surpluses.

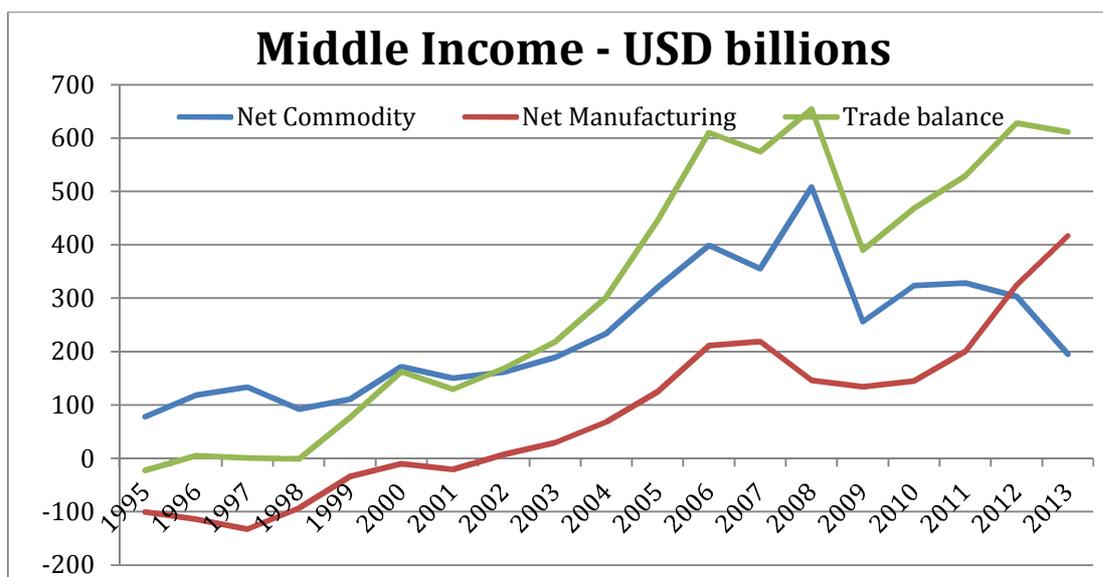
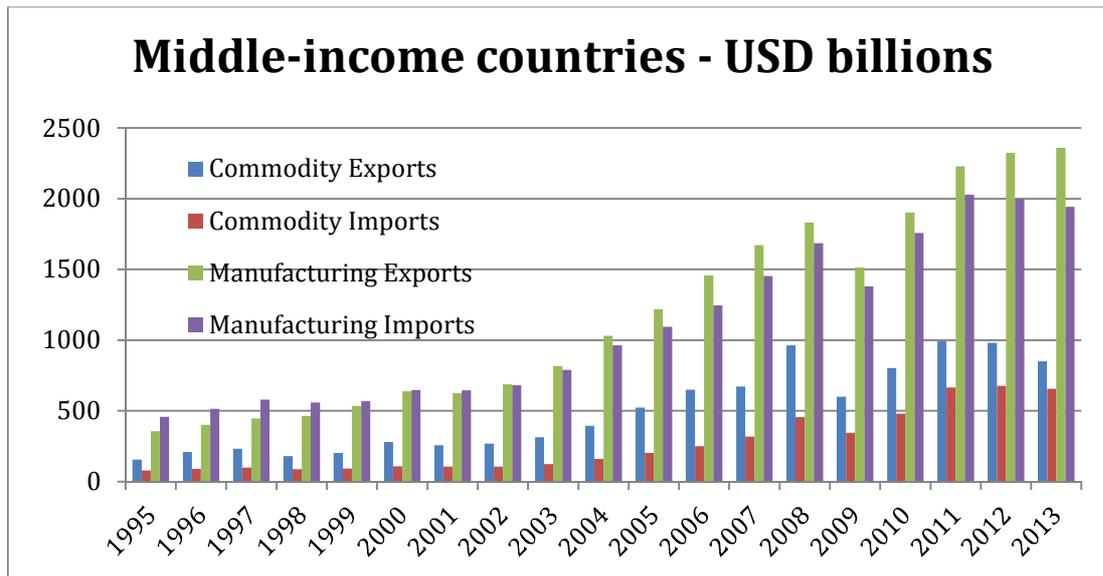
Thirdly, the impact of net remittances and official flows on low-income countries balance of payments is more substantial. In middle-income countries remittances fluctuated between 1% and 2% of GDP over the period and official flows have declined markedly since the turn of the century, consistently below 0.5%. On the other hand, in low-income countries net remittances have steadily grown to over 4% of GDP in 2009, and official flows fluctuated between 2% and 4%. This reflects the more advanced and financially integrated nature of middle-income countries.

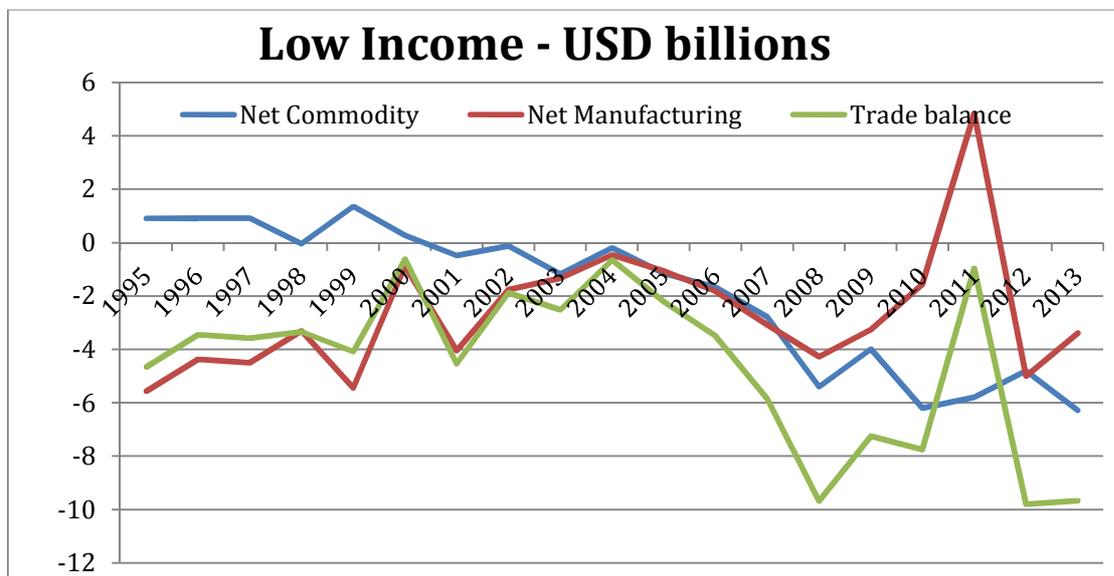
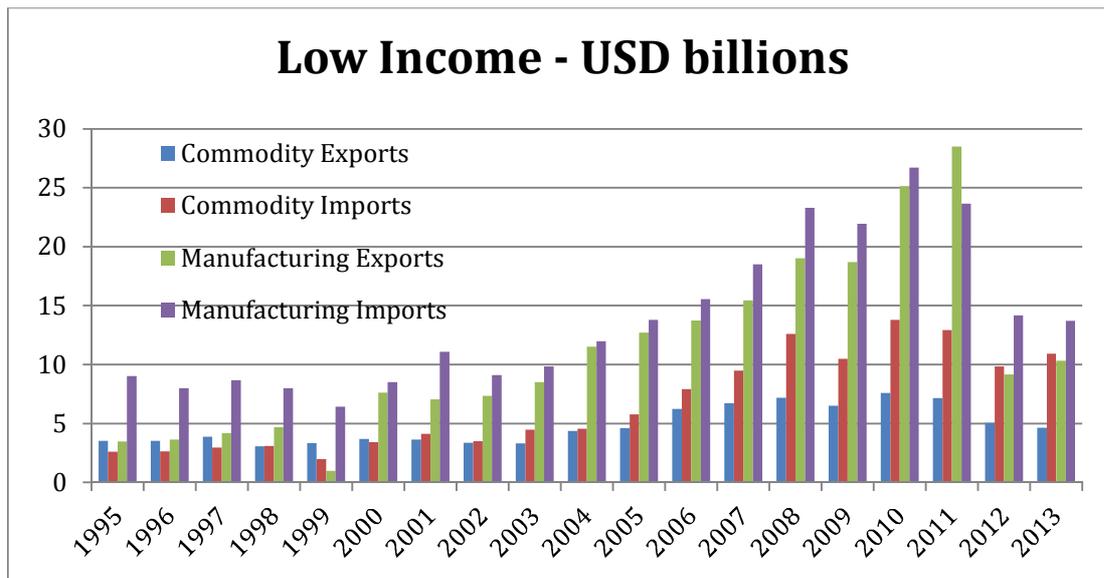
Finally, while both country groups consistently register negative net factor income positions, these deficits are smaller in middle-income countries and slowly improving over the course of the 2000's, and remain below -2% of GDP despite the negative impact of the crisis.

Comparing the trade statistics to Section 3 debt statistics, for the low income countries, in absolute numbers, the current account balance was in deficit and relatively stable during 1980 – 1997. When comparing this with the of rate accumulation of external liabilities presented in the first half of this report, we do not find there to be a coherent match, indicating that debt accumulation exhibits relative independence to the financing on trade deficits.

In middle income countries, the noticeable aspect of the current account balance in light of the debt statistics is that the rapid increase in trade surpluses from the late 1990s onwards has been matched by an equally rapid accumulation of external debts.

2.3.2 Trade

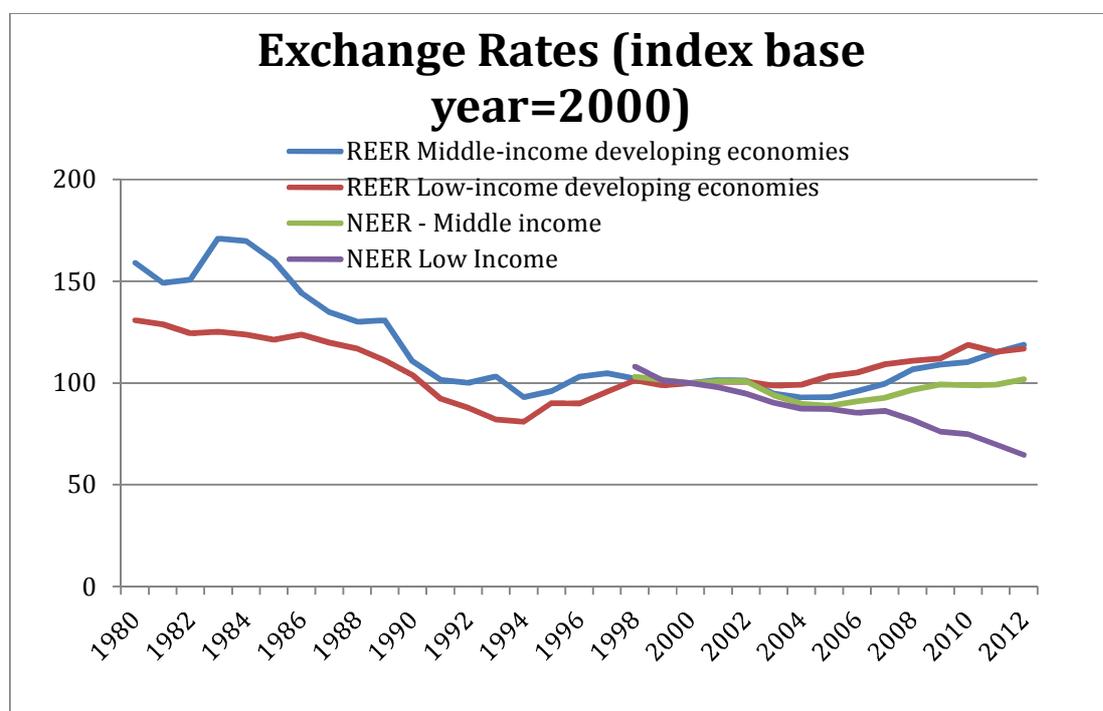
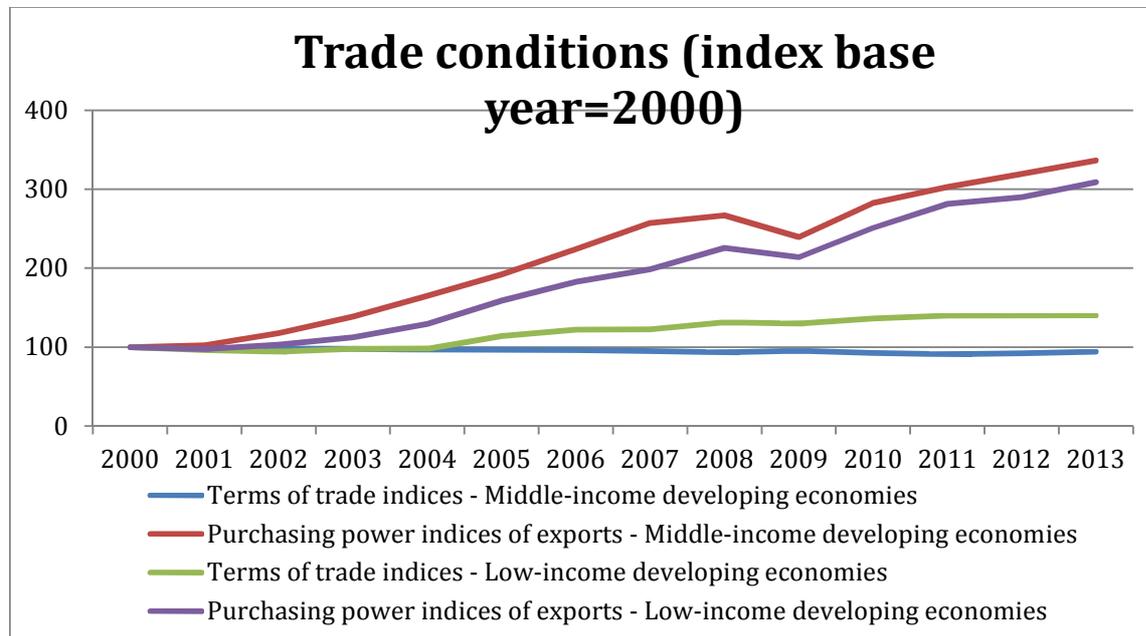




Middle-income and low-income countries experienced very different trade dynamics. Middle-income countries have experienced consistent and growing surpluses in the 2000-2008 period. The crisis seems to have hit commodity exports more sharply and persistently – possibly reflecting the decline of commodity prices - but a surge in net manufacturing exports compensated this decline, so that trade balance surpluses have recovered to their pre-crisis levels.

On the other hand, low-income countries have experienced trade deficits in both commodities and manufacturing goods. The crisis did not have major lasting impact on their net balances, but seems to have dramatically hit trade after 2011, with gross exports and imports declining substantially.

It is worth noting that when disaggregated by income group, developing and emerging countries do not seem to heavily depend on commodities trade.



Finally, it is worth noting that current accounts and trade balances do not seem to closely follow the dynamics of (real) exchange rates, which have appreciated over the past decade. At the same time however, the continuously improving terms of trade of middle-income countries may partially explain the positive trade and current account positions.

2.4 Concluding Remark

The findings of the preceding sections suggest three considerations. Firstly, the balance of evidence suggests that the developing world, in the period starting roughly at the turn of the century until the global financial crisis, has experienced a decade of relatively low “traditional” external vulnerability. Most countries experienced positive or balanced current accounts, which were primarily driven by the positive evolution of their (goods) trade accounts.

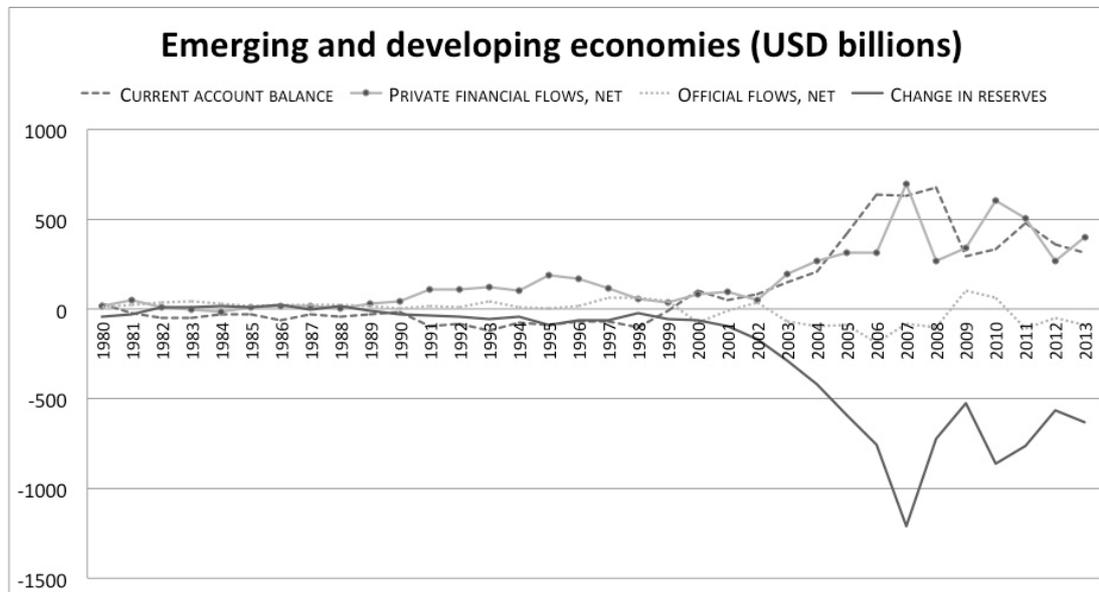
Secondly, net trade patterns seem to be more dependent on commodities, while manufactured goods by and large dominate gross trade. The trade surplus experienced by developing countries in the 2000's seems to be heavily influenced by the positive dynamics of commodity trade position. This is also reflected by the higher commodity share of exports in many regions, and conversely, by the growing importance of manufacturing imports. As a matter of fact the only region with consistent trade deficits is South Asia, the only net commodity importer. It is also noteworthy that these commodity surpluses can be found in middle-income countries, and thus do not necessarily reflect the reliance on commodities by the poorest and most technologically undeveloped countries. On the other hand, especially if China were to be included, manufactured goods trade would dwarf commodity trade. This is true in both low and middle-income countries.

Thirdly, the crisis that started in 2008 had a very sizeable impact on the external flows of developing countries. The evidence from aggregated and disaggregated data shows how all countries have experienced a deterioration of both their trade and current accounts, raising possible new concerns about their balance of payments fragility. This is particularly the case in low-income countries.

In sum, the combination of the evidence presented in this section and the previous one suggest that the characteristics of foreign debt accumulation in developing countries that we highlighted in Section 3 may not be made immediately coherent by the examination of the balance of payment positions.

3 Further analysis of financial globalisation

This section will provide evidence about financial integration of emerging and developing countries.

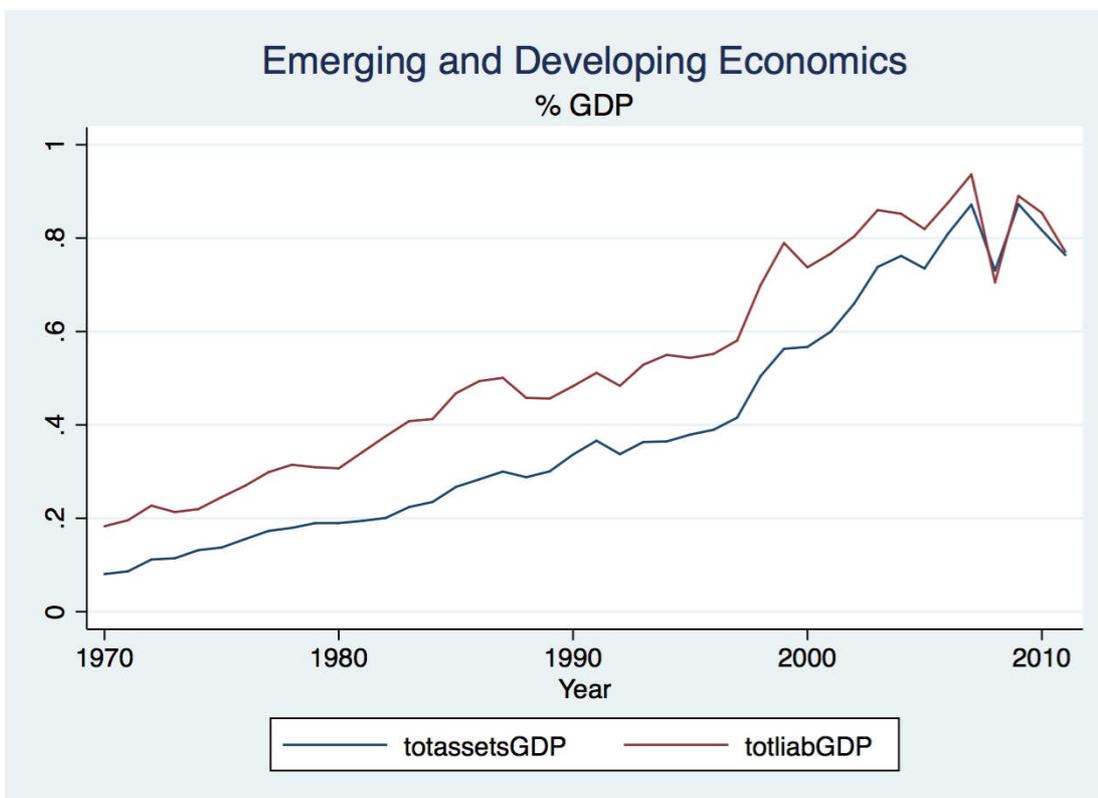
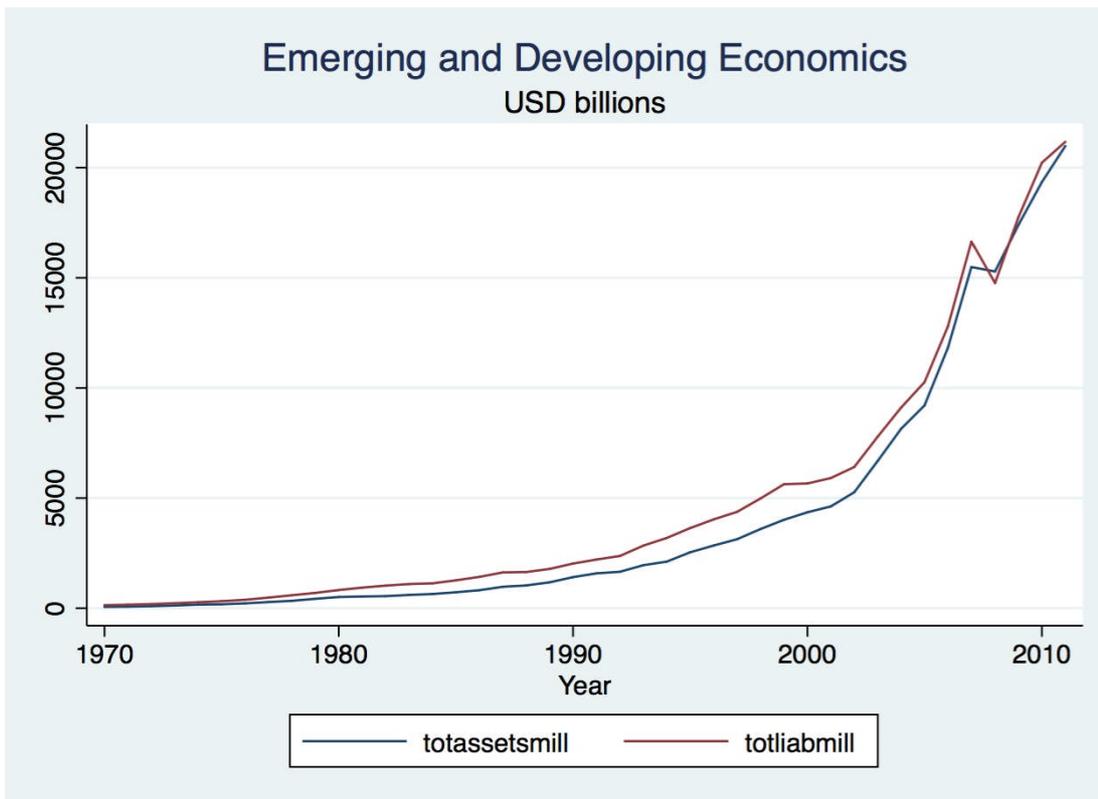


Source: IMF World Economic Outlook

As shown in figure the above, since the turn of the century there has been a substantial increase in net private inflows to emerging and developing economies. Net private inflows have increased from around 100 to over 500 USD billions between 2002 and 2007. In line with the findings of the previous section, this was accompanied by surpluses in the current account, which resulted in the explosion of the reserves accumulation which increased more than tenfold in the same period. While the global financial crisis has absorbed some of these increases, the levels of these positions remain at much higher levels than a decade ago.

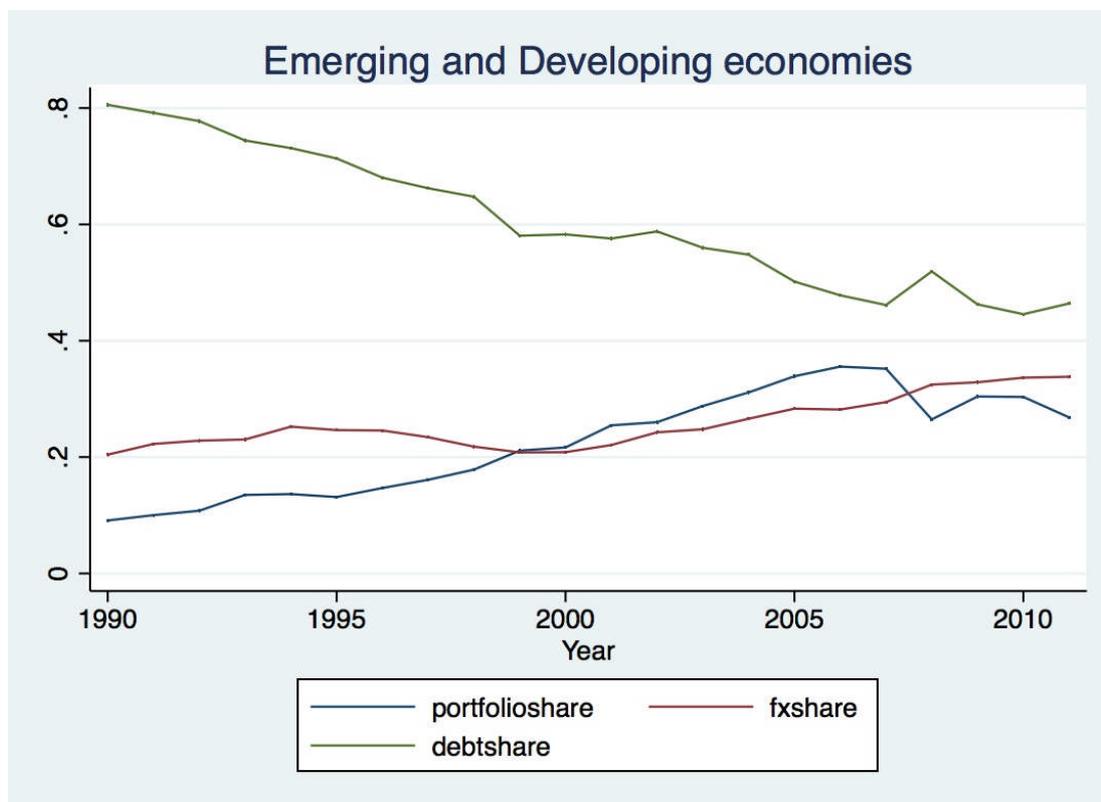
Emerging markets have been major recipients of private financial flows, which were mostly “recycled” back to advanced countries in the form of foreign exchange reserves. The causes of foreign exchange reserves accumulation can be variously explained¹¹ but nevertheless signal, along with the high net private capital inflows, the growing presence of emerging and developing countries in the global financial system.

¹¹ See deliverable 6.01 for an overview of the debates.



Source: updated and extended version of dataset constructed by Lane and Milesi-Ferretti (2007)

The data on cross-border holdings show a very similar picture. External assets and liabilities have been growing continuously since 1970, but their pace was particularly quick in the 2000', both in absolute terms and as a percentage of GDP. Another notable feature is the progressively narrowing gap between asset and liabilities over the same period, indicating an improving net foreign asset positions, a fact documented by Lane and Milesi-Ferretti (2007).

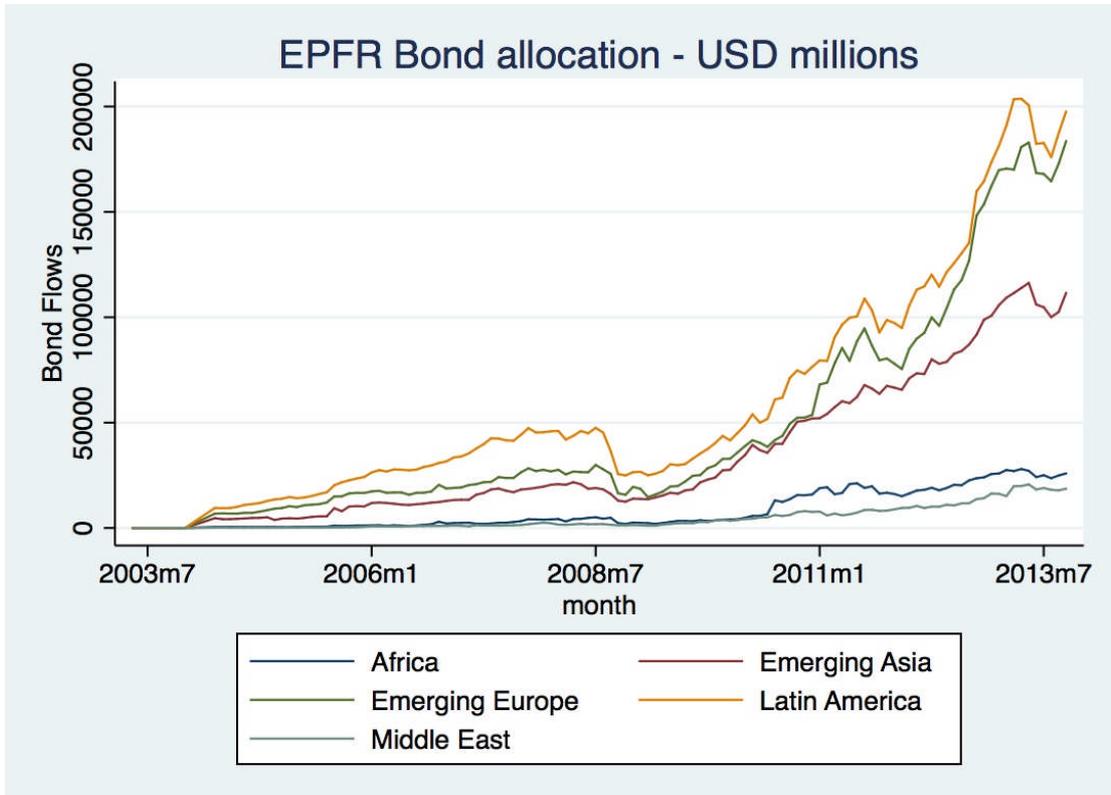
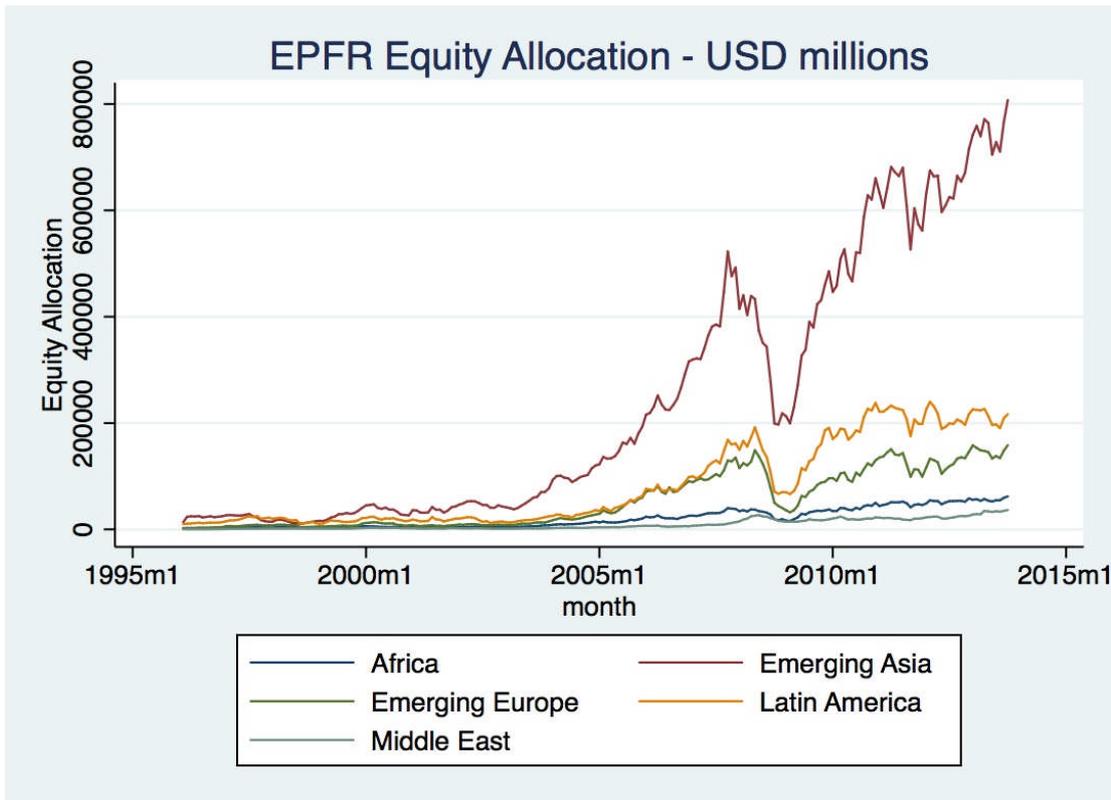


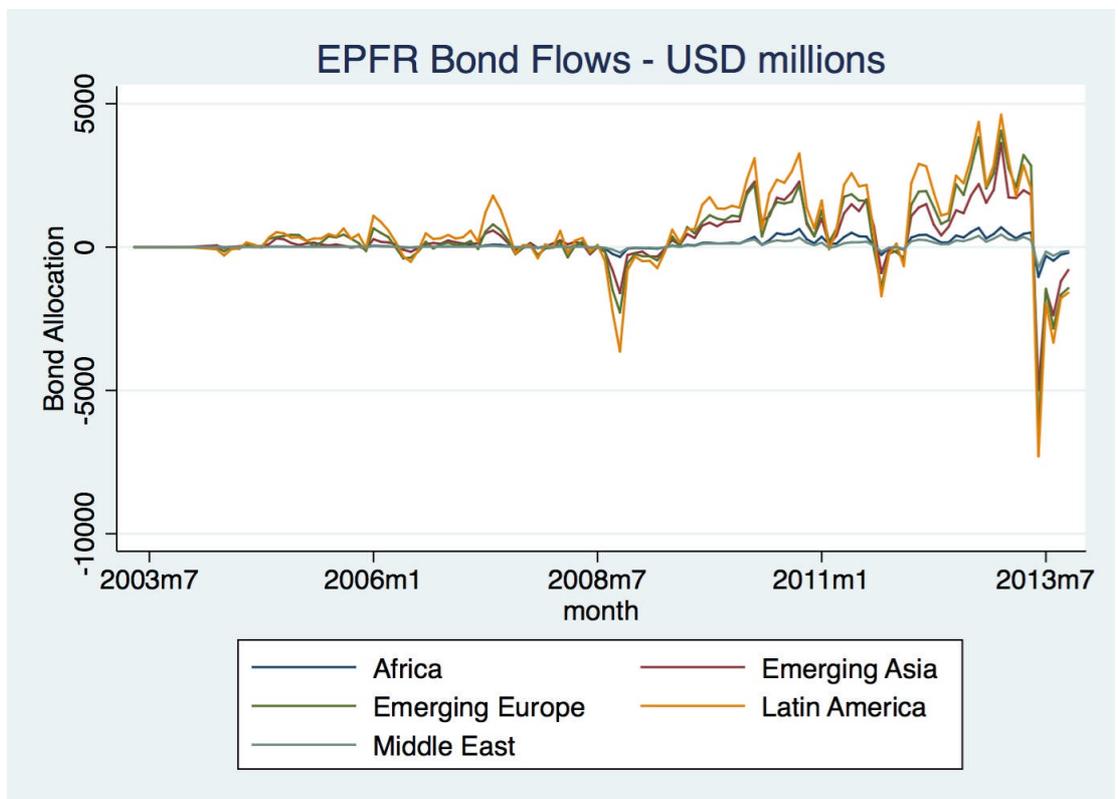
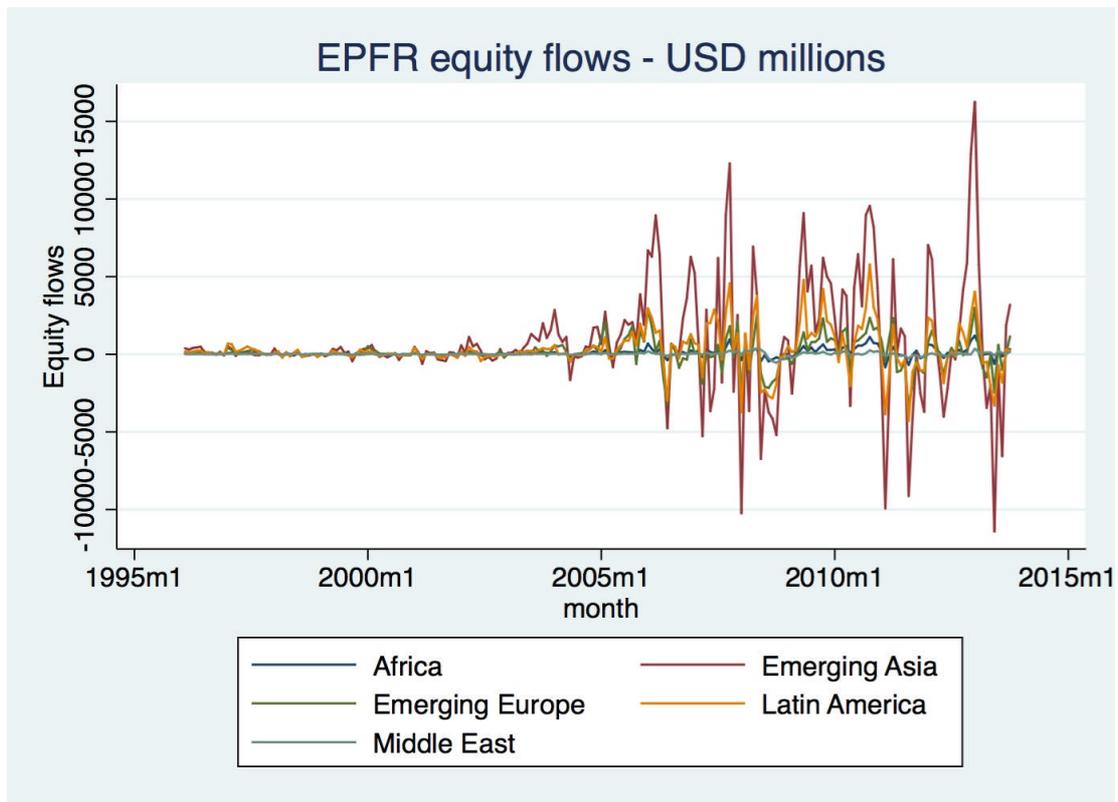
Source: updated and extended version of dataset constructed by Lane and Milesi-Ferretti (2007)

As expected the accumulation of foreign exchange reserves resulted in an increasing share of reserves to total external assets. This graph furthermore shows how the share of portfolio liabilities to total liabilities and that of debt (portfolio and other) liabilities have move almost symmetrically in opposite directions over the whole 1990-2010 period. The increase in the

portfolio liabilities share is especially remarkable since FDI also increased substantially in the same period. Once again it looks like the global financial crisis has had a slowing impact on these trends, but it has not reverted them. This is closely linked to the rapid and sustained increase in PNG debts analysed in section 3.

This seems to indicate an increasing importance of capital and bond markets in the dynamics of emerging and developing external liabilities. As highlighted in section 3, the ability of the private sectors in developing countries to borrow abroad has increased substantially. The regional breakdowns of long term external debts in section 3 indicate, the proportion of external liabilities taken up by securitised debts has increased. Indeed, as documented by Akyüz (2012), in many emerging economies foreign investors have become primary holders of capital and debt securities, as a result of the increasing portfolio flows targeting equities and local currency debt. This is also a result of the rise of corporations in emerging countries borrowing externally.





Source: Authors' calculation based on the EPFR database

The above graphs provide quite clear evidence of such increase in participation by foreign financial investors. The Emerging Portfolio Fund Research database, which collects data from mutual funds, shows how foreign investors' holdings of emerging markets equities and bonds have skyrocketed over the past decade. This confirms findings in Section 3 which indicate a growing composition of external debt being made up of private sector and public sector bonds. Equity holdings increased earlier, but bonds holdings have been catching up very quickly, especially after 2008. As a result, the magnitude of the flows representing purchases and sales of securities has similarly increased.

4 Conclusion

To conclude, financial globalisation has affected emerging and developing countries considerably, which during the 2000's have experienced a surge in private capital flows, which, together with the current account surpluses, have their mirror image in the accumulation of foreign exchange reserves. Cross-border asset positions have correspondingly increased, with the share of portfolio liabilities increasing and that of non-portfolio debt liabilities decreasing. In the same period net foreign asset positions have improved.

This evidence seems to be especially useful to further confirm and explain the findings of the previous sections. Indeed, emerging and developing countries are less vulnerable through the traditional channel: they are narrowing their net indebtedness. On the other hand the growing integration into the global financial system increases their exposure to portfolio investment which may raise different types of financial stability concerns. For example, the portfolio flows monthly swings have reached magnitudes of roughly 5 billions USD for mutual funds intermediated flows only, to each of the developing regions. This may indeed poses serious threats to the stability of the domestic financial markets as well as the foreign exchange markets of the developing and emerging countries.

The rapid accumulation of external debt does not seem to arise out of the need to finance growing trade deficits. The rise of private debt is concurrent with an increasing importance of cross border merger and acquisition activity and debt-financed FDI for the companies domiciled within emerging markets. This paper notes that the concern is the particularly rapid rise in private non-guaranteed debts as a source of potential financial vulnerability.

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THE ABSTRACT OF THE PROJECT IS:

The research programme will integrate diverse levels, methods and disciplinary traditions with the aim of developing a comprehensive policy agenda for changing the role of the financial system to help achieve a future which is sustainable in environmental, social and economic terms. The programme involves an integrated and balanced consortium involving partners from 14 countries that has unsurpassed experience of deploying diverse perspectives both within economics and across disciplines inclusive of economics. The programme is distinctively pluralistic, and aims to forge alliances across the social sciences, so as to understand how finance can better serve economic, social and environmental needs. The central issues addressed are the ways in which the growth and performance of economies in the last 30 years have been dependent on the characteristics of the processes of financialisation; how has financialisation impacted on the achievement of specific economic, social, and environmental objectives?; the nature of the relationship between financialisation and the sustainability of the financial system, economic development and the environment?; the lessons to be drawn from the crisis about the nature and impacts of financialisation? ; what are the requisites of a financial system able to support a process of sustainable development, broadly conceived?

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9	Centre for Social Studies, University of Coimbra	Portugal
10	University of Pannonia, Veszprem	Hungary
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