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Inside this issue:

Pandora Papers and tax havens: what do they tell us?

By Mitja Stefancic

Introducton: the "Pandora Papers" investigation

That the global capitalism is in a bad shape and in a rather unhealthy mood is no longer surprising. Its drawbacks include the widening gap between the holders of capital and those deprived from it (Pistor, 2019); and the fact that income is secured to the owners of physical or financial property at the expense of society (Standing, 2016). All this has been well-documented by scholarly research over the past years and some sociologists have therefore started questioning the survival of contemporary capitalism (see Streeck, 2016). Yet another telling case has recently emerged from a large international investigation, of which the outcomes show the problems arising in globalised capital markets.

On 3 October 2021 the International Consortium of Investigative Journalists (ICIJ) made public the outcomes from a large-scale investigation on financial fraud and tax avoidance entitled "Pandora Papers". Based upon what is defined as 'the most expansive leak of tax haven files to date' (ICIJ, 2021), the investigation reveals the secret deals and hidden assets of about 330 politicians and high-level public officials in 90 countries and territories worldwide. The outcomes are the result of research which lasted for two years and grew to encompass the work of more than 600 journalists in 117 countries and territories.

Focusing on tax havens, in the present comment I argue that the Pandora Papers provide us with a unique opportunity to reflect upon the global costs of tax avoidance and tax evasion. They also serve as the right moment to assess the analytical tools and methods that are available to narrow them down or, at least, keep them under control, provided that there is the political will to do so (Christensen, 2011).

The costs of tax avoidance and tax evasion

While tax evasion is the illegal circumvention of tax laws with an aim to minimize tax liability, tax avoidance is somewhat more controversial since it is in principle legal (Baker, 2013; Alstadsæter et al., 2018; Bird and Davis-Nozemack, 2018). There are several reasons why tax avoidance and evasion are socially unacceptable. For instance, while difficult to measure, they give rise to substantial compliance and administrative costs for both tax administrations and businesses, and to significant negative spillovers including distortions to competition and tax inequity (De La Feria, 2020).

The economic costs of tax evasion and, thus, of tax havens, are ultimately paid by ordinary citizens. In this sense, it is useful to recall what was already suggested twenty years ago by Mitchell et al. (2002, p. 7): 'tax havens are a bolthole for major corporations and the rich elite enabling them to evade/avoid taxes, responsibilities and regulations in their countries. They enable major corporations to hold societies to ransom and encourage corruption'.

According to the ICIJ (2021), while constituting a non-negligible global problem, the costs of tax avoidance and tax evasion are harmful to any economy, regardless of its size or geographical location. However, poorer nations are those bearing the largest costs from the above-mentioned phenomena. To quote from the ICIJ (2021): 'poor nations are disproportionately harmed by the stashing of wealth in tax havens, which starves treasuries of funds to pay for roads, schools and hospitals'. Therefore, the question that one should ask is the following: *Why are tax havens currently still so popular and so diffused?*

Characteristics of tax havens

Source: collectif RYBN.ORG http://rybn.org/thegreatoffshore

Tax havens have become prominent features of globalised capital markets (see for instance Christensen, 2011). Desai et al. (2006) argue that tax haven operations facilitate tax avoidance by multinational firms and wealthy individuals, permitting them to allocate taxable income away from regulated high-tax jurisdictions. Profit-oriented banks may also make use of tax havens to store their profits, often in a non-transparent way (Janský, 2020).

Past research showed that most tax havens have a number of distinctive characteristics that need to be taken into proper account. To begin with, some countries or specific territories are more likely to offer tax avoidance schemes than others. Masciandaro and Portolano (2003) convincingly argue that tax havens are structurally different from other countries in that they lack the resources for engaging in international trade. This has historically forced them to generate income through a loose supervisory regime. As noted by Christensen (2011), tax havens are characterised by financial markets opacity.

In their account, Tobin and Walsh (2013) stress two defining features of tax havens, namely: a) favourable regimes for foreign investors; and b) banks' secrecy. Furthermore, as suggested by Masciandaro (2008), the type of regulation of offshore financial centres and tax havens depends on their structural features: the probability of being a tax haven is greater with higher political stability and lower crime levels, but also a lower level of diplomatic voice in international organisations. Lastly, according to Masciandaro (2008) such probability tends to be higher if the country or territory is characterised by a Common Law juridical system.

Technological tools and the role of changing technology

New technologies and analytical tools can be usefully applied with the aim to securing a more effective control on tax avoidance and evasion both on a national and a global level. In addressing the issue of financial crime, more or less recent studies (such as Sudjianto et al., 2010; Wu et al., 2012) show the usefulness of reliable estimation methods and techniques based on algorithms and data mining. In addition, Vanhoeyveld et al. (2020) have successfully applied the so-called Anomaly Detection methods to firms belonging to the same economic sector, thus developing an efficient auditing strategy that could be adopted by tax authorities worldwide in tackling tax evasion. Furthermore, according to Bird and Davis-Nozemack (2018) a variety of new sustainability metrics have the capacity to incorporate anti-tax avoidance measures, thereby helping to sharpen the focus on the related issues.

It is plausible to assume that changing technology will make tax evasion increasingly difficult for most taxpayers in the years to come (Alm, 2021). The above-mentioned tools and analytical approaches, if applied wisely, can provide reliable estimates for detecting large tax evasion schemes and international tax evasion networks. In this sense, they can be very useful to Government agencies and financial supervisory authorities. Last but not least, novel conceptual frameworks are emerging for an improved understanding of the tax fraud phenomena, informed by insights from a variety of disciplines including tax law, public economics, criminal justice, economics of crime and regulatory theory (De La Feria, 2020).

Conclusion

Investigations such as the Pandora Papers unveil the most pressing problems of the so-called liberal democracies. They also seem to suggest that it may be necessary to change tax laws and improve regulations to achieve a better balance between public incentives and public interests. Contemporary capitalism is nowadays miles away from the ideal economic system envisaged by Francis Fukuyama (1992) at the turn of the century, able to elegantly balance liberty and equality and thus grant social and economic progress. Given their dimensions, tax evasion and tax avoidance seem to be systemic to global capitalist economies. From this point of view, it is rather surprising that, as some experts observed, the outcomes from the "Pandora Papers" investigation have at first obtained relatively low public interest (see Greggi, 2021).

Nevertheless, on a more positive side, it appears that there is sufficient knowledge and the know-how necessary to adequately contrast the above-mentioned phenomena. Improved conceptual frameworks and more accuracy in the concepts being used can also help in cracking down on them. In this sense, the fact that the European Parliament (2021) has for instance put the fight against tax fraud, tax evasion and tax avoidance on the top of its priorities seems to be good news. This may in fact signal the existence of the political will which is essential to decrease the levels of tax avoidance and tax evasion, and thus save money for valuable investments in fundamental public services and for the citizens that need it most, thereby also reducing inequality.

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Brazilian Foreign Policy: crisis and preliminary effects on International Cooperation and Development[1]

By Patrícia Andrade de Oliveira e Silva[2] and Pietro Carlos de Souza Rodrigues[3]

Introduction

In recent years, Brazil has been a synonym for intense and multiple crises: in politics, in the economy, and in the social domains. Back in the 2000s, the country's landscape was very different: a model for public policies, which were distinguished by their capacity to reach the poor and by providing governance features adapted to a third world context. Because of that, Brazil explored new areas of foreign policy by enhancing International Cooperation and Development (ICD). A characteristic in this type of cooperation is the presence of solidarity as a principle to face the dilemmas and inequalities generated by capitalism (MILANI 2012). Observing the positive context of Brazilian ICD policies in the 2000s, "national interests were structurally brought into conformity with ICD objectives (starting with the Zero Hunger initiative that eventually gained international recognition for their significant results in fighting hunger and poverty)". (SILVA and ALMEIDA FILHO, 2020, p. 39).

Nevertheless, after 2016 this scenario changed drastically driven by a political crisis (the impeachment of the former president Dilma Rousseff), and an economic and social crisis (severe fiscal adjustment, when approved by the Constitutional Amendment 95), which structurally decreased resources available for ICD and consequently limited possibilities to continue deepening international cooperation.

After the Covid-19 pandemic outbreak, the situation deteriorated further, with disastrous consequences for Brazil's international engagement. The social effect is seen by the fact that 27.4 million people in Brazil live on less than R$261 a month (approximately US$48), the highest extreme poverty rate in a decade[4].

This article aims to explore the preliminary effects of these crises on Brazilian foreign policy, focusing on changes in the role of ICD and its consequences.

Methodology

To analyze the preliminary consequences for cooperation of changes in Brazil's politics and economy , we conducted a delimited and contextualized qualitative questionnaire about the perceptions of specialists in International Relations (IR) regarding the Brazilian Foreign Policy and the ICD. We collected answers regarding Brazil's foreign policy advances and setbacks in the last 20 years, comparing two distinct periods (2000-2010 and 2010-2020).

The anonymous questionnaire was constructed through an online survey and answered by IR professionals in April 2021. All interviewed had at least one year of professional experience in (or with) the Brazilian government. The 13 questions were divided into three groups: a) professional trajectory and direct or indirect experiences with the Brazilian government; b) an individual evaluation regarding the Brazilian foreign policy in the last decade (2010-2020) compared to the previous decade (2000-2010) and c) an individual evaluation about ICD evolution over the given periods.

We reached sixteen (16) professionals with different experiences. A significant portion of the interviewees had between 11 to 20 years of experience in international cooperation (37.5% of respondents) and 75% of them had professional experience with the Brazilian government, especially between 2010-2020. With regards to the professional relationship with the Brazilian government, most respondents had experiences in different positions (or multiple answers): as commissioned position (4), as a public servant (5), as academics (5), as diplomat (1) and as a member of an international organization team (9). Furthermore, some professionals had provided external technical assistance and private services.

Preliminary results and considerations

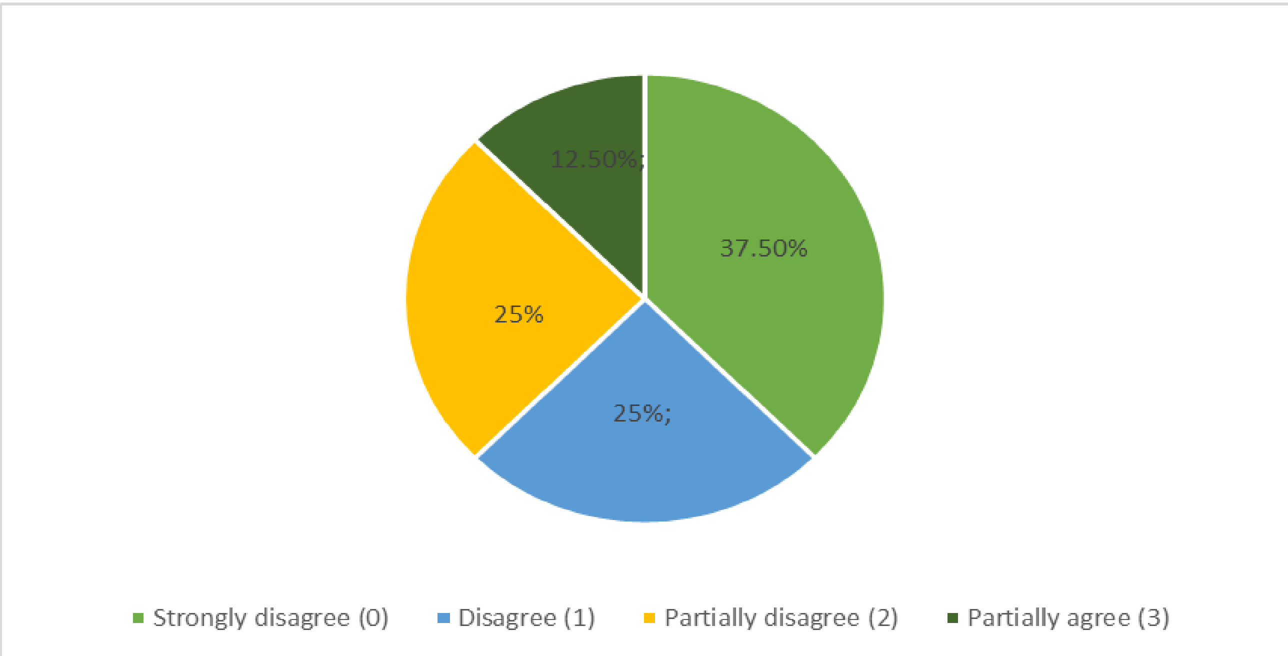
Regarding the professional experience, 8 of respondents worked in ICD projects that involved the Brazilian government between 2000-2010. Considering a scale from 0 to 5 (with 0 being a terrible experience, and 5 being excellent), half of them evaluated their experiences as very good. When the same question was oriented to the following decade (2010-2020), the respondents also pointed out their experiences were very good (4).

Four (4) out the sixteen (16) respondents had experience working for ICD projects that involved the Brazilian government in both periods (2000-2010 and 2010-2020). Those were professionals with extensive international experience (11-20 years), most of them having worked in international organizations. In this group, the evaluations of their experiences were positive and coincident in both decades (5 - excellent or 4 - very good, on a scale 0 to 5).

When asked to compare the Brazilian foreign policy between 2000-2010 and 2010-2020, using a scale from 0 (equal) to 5 (completely different), more than 90% of them believed that foreign policy conducted by the Brazilian government between 2010-2020 was very different from the previous decade (4 and 5). When requested to give reasons to differences in perceptions, the answers highlighted the reduction of Brazilian international prominence with international organizations, quality changes in Brazilian international discourses - including official diplomatic representation - and the recent upsurge of a populist posture much less favorable to human rights guarantee when compared with the previous period (2000-2010).

We also asked participants to react to the affirmation that "Brazilian foreign policy between 2010-2020 was excellent when compared to the previous period (2000-2010)", using a scale from 0 (strongly disagree) to 5 (totally agree). Figure 1 shows that more than 60% of them partially or totally disagreed with the statement. Nobody agreed or totally agreed.

Figure 1. Statement's evaluation: "Brazilian foreign policy between 2010-2020 was excellent when compared to the previous period (2000-2010)".



Source: field research

Exploring the previous question, professionals were asked to list the main changes (positives and negatives) of Brazilian foreign policy in 2010-2020 compared to the previous decade. Except for three (3) respondents, participants stated no positive changes over the past decade. However, some exceptions were: a) 2010-2015 as period of projects carried over from the golden years of former president Lula's diplomacy; b) the end of political alliances with left autocratic regimes such as African and Asian dictatorships for ideological reasons in 2016 and c) the trade agreement between the European Union and Mercosur in 2019, with potential to increase bilateral trade and investments.

We also formulated open questions about the perceptions on changes in Brazilian foreign policy and all participants mentioned negative changes, which included: a) the reduction of the country's international role and its capacity to dialogue with governments and international organizations; b) the change in Brazilian diplomacy posture regarding basic human rights and sustainability (such as the denial of the Paris Agreement); c) the loss of a leading role in MERCOSUR and BRICS; d) the aggressive approach towards China and the total alignment with the USA and Israel in international security and middle eastern conflicts and; e) the excessive focus on trade agreements, leaving aside other types of international cooperation matters, especially ICD initiatives.

The last section of our questionnaire presented questions regarding the perceptions about Brazilian performance in the conducting of its international agenda during the COVID-19 pandemic. We asked participants to evaluate the statement: "During the coronavirus pandemic, Brazilian foreign policy is contributing to the fight against virus dissemination, for example: agreements for purchase of supplies and vaccines (on a scale 0 to 5, where 0 means totally disagree and 5 totally agree)", the answers were massively negative. More than 80% (13 out 16) totally disagree with the statement. Just one of them partially disagreed, due to the country's participation in the Covax Facility International Consortium, coordinated by the World Health Organization (WHO)[5]. Even with the delay to close the deal, the respondent found the closing of the agreement sufficiently positive to moderate a more negative evaluation over Brazil's international performance.

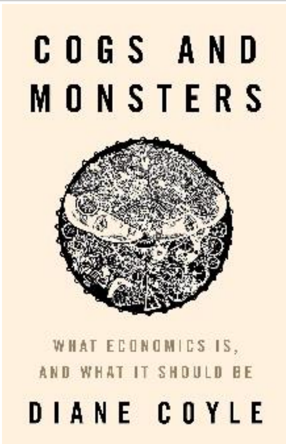
Lastly, when requested to explain aspects of Brazil's management, a negative judgement of the efficiency of the foreign policy was clearly highlighted. Among other statements, respondents mentioned: a) the denial of the pandemic's severity and of the importance of preventive measures; b) the delay in the acquisition of vaccines; c) the poor national coordination on controlling the entry/exit movement from national territory; d) the insufficiency of efforts to establish dialogue and negotiate channels with foreign governments and international organizations to make viable the effective measures to control the spread of the disease and, e) the absence of partnerships with BRICS and Southern Cone countries to deal with common challenges.

The qualitative perceptions from international relations professionals about Brazilian foreign policy and ICD over the last two decades indicate a dangerous decline in Brazil's role in the international arena. One of the main effects is the disarticulation of a potentially positive structure able to deal with international crises, which demand global coordina-

On Diane Coyle's Cogs and Monsters

By Lars Syll

Macroeconomists seem to me the biggest offenders n not taking such empirical issues (of practical data handling) seriously enough. This might sound like sheer contrarianism given that macroeconomists are constantly wielding data; after all, their business is analysing the behaviour of the whole economy and forecasting its future path. My concerns are, first, that too few think about the vast uncertainty associated with the statistics they download and use; and secondly, how difficult it is to draw definitive conclusions about economy-wide phenomena, the aggregated outcomes of choice made by millions of businesses and consumers interacting in specific historical and geographic contexts, and social and political relations.



There's a lot in this new book by Diane Coyle that I like, and I highly recommend reading it.

Unfortunately, there are also some things in it I find very hard to swallow.

A recurrent theme in the book — as in her earlier *The Soulful Science* (2010) — is Coyle's view that much of the critique waged against mainstream economics from heterodox economists like yours truly and others are more or less of a straw-man kind and that we haven't really understood the fact that economics "has changed a lot in two decades."

One example she refers to — to underpin her view — is the development of the 'new' behavioural, 'experimental,' and 'empirical turn' in economics.

So let's take a look at that and what some of us 'heterodox' economists really have had to say about it.

Coyle — as many other more or less mainstream economists nowadays — seems to maintain that the empirical methods developed within economics — natural experiments, field experiments, RCTs — help us to answer important economic questions. I beg to differ. When looked at carefully, there are in fact few real reasons to share the optimism on this 'empirical turn' in economics.

Field studies and experiments face the same basic problem as theoretical models — they are built on rather artificial conditions and have difficulties with the 'trade-off' between internal and external validity. The more artificial conditions, the more internal validity, but also less external validity. The more we rig experiments/field studies/ models to avoid the 'confounding factors', the less the conditions are reminiscent of the real 'target system.' You could of course discuss the field vs. experiments vs. theoretical models in terms of realism — but the nodal issue is not about that, but basically about how economists using different isolation strategies in different 'nomological machines' attempt to learn about causal relationships. I have strong doubts about the generalizabiy of all three research strategies because the probability is high that causal mechanisms are different in different contexts and that lack of homogeneity/stability/invariance doesn't give us warranted export licenses to the 'real' societies or economies.

By this, I do not mean to say that empirical methods *per se* are so problematic that they can never be used. On the contrary, I am basically — though not without reservations — in favor of the increased use of experiments and field studies within economics. Not least as an alternative to completely barren 'bridgeless axiomatic-deductive theory models. My criticism is more about aspiration levels and what we believe that we can achieve with our mediational epistemological tools and methods in the social sciences.

Limiting model assumptions in economic science always have to be closely examined since if we are going to be able to show that the mechanisms or causes that we isolate and handle in our models are stable in the sense that they do not change when we 'export' them to our 'target systems,' we have to be able to show that they do not only hold under *ceteris paribus* conditions and *a fortiori* only are of limited value to our understanding, explanations or predictions of real economic systems.

Real-world social systems are not governed by stable causal mechanisms or capacities. The kinds of 'laws' and relations that econometrics has established, are laws and relations about entities in models that presuppose causal mechanisms being atomistic and additive. When causal mechanisms operate in real-world social target systems they only do it in ever-changing and unstable combinations where the whole is more than a mechanical sum of parts. If economic regularities obtain they do it (as a rule) only because we engineered them for that purpose. Outside man-made 'nomological machines' they are rare, or even non-existent.

Taking assumptions like utility maximization or market equilibrium as a matter of course leads to the 'standing presumption in economics that, if an empirical statement is deduced from standard assumptions then that statement is reliable' …

The ongoing importance of these assumptions is especially evident in those areas of economic research, where empirical results are challenging standard views on economic behaviour like experimental economics or behavioural finance … From the perspective of Model-Platonism, these research-areas are still framed by the 'superior insights' associated with early 20th century concepts, essentially because almost all of their results are framed in terms of rational individuals, who engage in optimizing behaviour and, thereby, attain equilibrium. For instance, the attitude to explain cooperation or fair behaviour in experiments by assuming an 'inequality aversion' integrated in (a fraction of) the subjects' preferences is strictly in accordance with the assumption of rational individuals, a feature which the authors are keen to report …

So, while the mere emergence of research areas like experimental economics is sometimes deemed a clear sign for the advent of a new era … a closer look at these fields allows us to illustrate the enduring relevance of the Model-Platonism-topos and, thereby, shows the pervasion of these fields with a traditional neoclassical style of thought.

Jakob Kapeller

Contrary to Coyle's optimism, I would argue that although different 'empirical' approaches have been — more or less — integrated into mainstream economics, there is still a long way to go before economics has become a truly empirical science.

Almost all the change and diversity that takes place in mainstream economics today only takes place within the analytic-formalistic modeling strategy that makes up the core of mainstream economics. All the flowers that do not live up to the precepts of the mainstream methodological canon are pruned. You're free to take your analytical formalist models and apply them to whatever you want – as long as you do it using a modeling methodology acceptable to the mainstream. If you do not follow this particular mathematical-deductive analytical formalism you're not even considered doing economics. "If it isn't modelled, it isn't economics." This isn't pluralism. It's a methodological reductionist straightjacket.

No matter how many thousands of models mainstream economists come up with, as long as they are just axiomatic variations of the same old mathematical-deductive ilk, they will not take us one single inch closer to giving us relevant and usable means to further our understanding and explanation of real economies.

So — in conclusion — it is not that heterodox critics haven't noticed the development in mainstream economics that has taken place during the past 20-30 years. We have noticed — and understood that it still far too much builds on the same old neoclassical straight-jacket methodology.

Combatting Global Warming: The Solution to China's Demographic "Crisis"

By Dean Baker

There have been numerous news articles in recent years telling us that China faces a demographic crisis. The basic story is that the market reforms put in place in the late 1970s, together with the country's one-child policy, led to many fewer children being born in the last four decades. As a result, the number of current workers entering retirement exceeds the size of the cohorts entering the workforce, leading to a stagnant or declining workforce. This is supposed to be a crisis.

I used the word "supposed" because it is not in any way obvious that a declining workforce is any sort of crisis. We see shifts of population all the time, which can lead many cities or regions to have a decline in their population or workforce, even if the country as a whole does not. That doesn't necessarily mean a crisis for the areas losing population unless of course the population decline is due to the loss of a major employer.

A drop in the growth rate of the workforce, or an actual decline, will likely mean slower GDP growth, but so what? A country's standard of living is determined by its income per capita (along with many other factors), not its absolute level of GDP. India's GDP is almost eight times Denmark's, but Denmark is the far richer country. The reason is that India has more than two hundred times as many people.

If a country's growth rate is slower because the growth rate of its workforce slows, that is hardly a disaster. People can still be seeing improvements in their standard of living, and in the case of China, these improvements would still be quite rapid even if its annual growth rate slowed by 2-3 percentage points from its recent pace of more than 6.0 percent annually.

There is a common argument that countries with aging populations, like China, will suffer because each worker will have to support a larger number of retirees. It is easy to show that this view is silly. Even a modest rate of productivity growth will swamp the impact of a declining ratio of workers to retirees. With output per worker increasing, both workers and retirees can enjoy rising living standards even as the ratio of workers to retirees fall.

That should not sound surprising. The ratio of workers to retirees has been falling in the United States for the last two decades, yet we have seen substantial increases in living standards, even if the wealthy have gotten the bulk of these gains. The idea that China's declining ratio of workers to retirees poses a supply-side problem, where it cannot produce enough goods and services to support its population, is absurd on its face.

The Problem of Secular Stagnation

It turns out that the major problem of an aging population is not too much demand, but rather too little. Older people tend to spend less money than people in their working years. Also, when a country's workforce is not growing, companies need to spend less money on investment. Employers need more capital when they hire more workers. This could mean desks and computers, or it could be machinery in a factory, or a truck on the road. The more workers companies hire, the more capital they need, which means more investment.

But if the workforce stagnates, then companies need to spend less on investment. They will still modernize their equipment and replace worn out items, but they don't have to invest to accommodate the needs of a larger workforce.

With both consumption and investment falling relative to GDP, economies will face the problem of inadequate demand. In principle, the economy is capable of producing more goods and services than households and businesses are prepared to buy. This is the situation that we faced in the Great Depression, and again, on a smaller scale, in the Great Recession. It means mass unemployment. In the Great Depression, unemployment peaked at 25 percent of the workforce.

It is ironic that the economists warning about the implications of an aging population not only got the magnitude of the problem wrong, they even got the direction wrong. With our aging population, we don't have to worry about too much demand, we have to worry about too little. This is yet another example of the old saying that economists are not very good at economics.

Spending Money: The Cure for Secular Stagnation

We discovered the cure for secular stagnation in the 1930s: the government has to spend money to make up for the failure to spend by the private sector. President Roosevelt embraced this strategy to a limited extent with his New Deal programs. These put millions of people back to work while modernizing our housing and infrastructure.

Of course, the government spending program that really got the economy back to full employment was World War II. With the country united behind the need to defeat Germany and Japan, budget deficits ceased being an issue. We saw record low unemployment rates in the war years as tens of millions of workers were either serving in the military or producing the food, clothes, and weapons needed by the military.

The war provided the political support for massive spending (and budget deficits), but it was the spending that got the economy to full employment. Money spent on civilian uses will create jobs every bit as well as money spent on the military.

This brings us back to China's demographic crisis and global warming. As Paul Krugman wrote in a recent column, China is going to have to make a massive adjustment in its economy in the years ahead. It has been spending an incredible 43 percent of its GDP on capital formation, either investment goods purchased by businesses, or residential housing. By comparison, the figure for Japan is 24 percent and for the United States less than 22 percent.

This massive spending on capital formation made sense when China was seeing rapid growth in its labor force and also a huge shift in its population from rural to urban. But this process is now reaching an endpoint, both with a decline in its working-age population and the rural to urban shift largely completed.

Currently, over 62 percent of China's population lives in urban areas. The figure for most wealthy countries is close to 80 percent, but the pace of shift for China will be much slower going forward than in the past. In 1980, less than 20 percent of its population was urban.

This means that China's big problem going forward is to find a way to spend a very large amount of money. For simplicity, let's say that their needed spending on capital formation falls to 23 percent of GDP, roughly splitting the difference between Japan and the United States. This would mean that China's government has to figure out what to do with 20 percent of its GDP.

This is an incredible amount of money. In 2021, 20 percent of China's GDP would be $5.4 trillion. According to the I.M.F.'s projections, the annual amount would be almost $8 trillion in 2026. Over the next decade, it would be more than $80 trillion, that's more than 20 times the original $3.5 trillion Build Back Better plan. In short, it's real money.

It is also important to note that China is already heavily invested in clean energy. China is by far the world leader in solar energy, with more than twice as much as the United States, the second-largest user of solar power. It is also by far the world leader in wind energy, again with more than twice as much installed wind power as the United States. And, China also has more than twice as many electric cars on the road as any other country.

This means that China has a large domestic clean energy sector which can stand to gain by further spending on reducing greenhouse gas emissions. Of course, no one expects that the country will spend anything like $80 trillion over the next decade reducing greenhouse gas emissions, but it certainly can commit considerable resources to this effort. In addition to the benefits to the environment, this spending will help China's economy grow and keep its workforce employed.

This is one of the opportunities created by China's supposed demographic crisis. The issue is that because of the aging of the population it faces the prospect of a huge shortfall of demand in the economy. This is a good problem for a country to have, if its leadership is adept at managing its resources.

There are many grounds on which to criticize China's government. It severely represses minority populations, most extremely the Uighurs, many of whom have been imprisoned for months or even years. It also does not respect freedom of speech, freedom of the press, or basic labor rights. But there is no doubt that it has done an outstanding job in managing its economy over the last four decades in a way that has led to an enormous improvement in living standards for the overwhelming majority of its population.

If China wants a path through its "demographic crisis," or, in other words, coping with secular stagnation, devoting substantial resources towards greening its economy would be a great path forward. In the process, they can also give a big hand to the rest of the world, both by sharing the technology and showing how it can be done, as well as reducing the damage they are doing to the planet themselves.

Regulation of international capital flows in developing countries: institutional and political challenges in their implementation

By Juan Carlos Moreno-Brid and Lorenzo Nalin[1]

History has shown again and again that emerging market economies (EMEs) - even when they have solid macroeconomic fundamentals - may suffer acute balance of payments cum fiscal crises. The pattern of such recurrent crises in the developing world has both endogenous and exogenous roots. Indeed, some of such dramatic episodes have had their origin in fully-developed economies, like the international financial crisis of 2008-09. Or in other regions of the developing world, the most recent one is the covid-19 pandemic. Certainly, EMEs´ macroeconomic busts may be rooted too in internal phenomena, episodes of economic mismanagement or of domestic political tensions. Independently of their origin, all of them are accompanied by massive capital flight and a sharp collapse of fixed capital formation and domestic output, and even civil unrest and violence.

In EMEs´ recurrent boom-bust processes, short-term international capital flows have been and continue to be an important component, increasing systemic risk and sharping financial fragility in the recipient country.[2] These flows certainly may serve as a source to finance development. But, as recognized in the economic development literature, they tend to play a destabilizing role, both in their entry in massive amounts which tends to appreciate the domestic currency as well as in their abrupt exit which brings about a loss of reserves that eventually detonates a full-blown balance of payments crisis.

By now, there is abundant theoretical support for capital flow management (CFM) to be considered as a legitimate tool in emerging market economies to improve their resilience against financial turmoil.[3] In fact, even the IMF, stressing the pervasive destabilizing effects of short term capital flows, has come to recognize CFM as a legitimate and useful instrument of the macroeconomic policy tool kit.[4] That it should be admitted as a standard, all-weather instrument of macroeconomic prudential regulation as opposed to a sort of last resort fire extinguisher to be used only in case of emergency is a point where consensus is swiftly being built.

Why is the application of CFM so scarce in the developing world? Is it due to, say, ignorance or lack of information by top officers in Central Banks and Ministries of Finance on the merits of such CFM? Hardly! In the vast majority of developing countries, these positions tend to be filled by sophisticated, well-trained professionals who regularly participate in high-level meetings and seminars organized by international financial organizations. Certainly, some years ago, the tendency in the popular literature on CMF was to stress negative experiences. The only one in Latin America that was systematically recognized as a success story was Chile in its use of "prudential" measures to contain foreign capital inflows for quite some time, until the financial liberalization program in the early 1980s. There is consensus that the removal of such measures led to massive capital inflows, real exchange rate appreciation and a credit boom that ultimately resulted in a crash.[5] However, in the last say ten years this narrative has changed. In fact, numerous meetings in international financial organizations - inter alia, the IMF, the BIS - focusing on the challenges posed to macroeconomic stabilization by massive and volatile foreign capital flows have more and more concluded that CFM can and should be a tool of macroprudential concerns.

In our view there are two main reasons for the reluctance to impose CFM in emerging economies. The first one is the technical challenge that its implementation imposes on regulators, the functioning of the domestic circles of financial intermediation and on their international partners. The second one, equally important, is the historical cum institutional context as well as the status of the main domestic economic and political forces with vested interests in the dynamics and effects of short-term capital flows.

Certainly, the challenges brought about by a potential application of CFM have an important technical component. How, in a globalized, open and modern economy, can CFM measures be put in place with minimum disruptive effects? But the most significant challenges that CFM faces to become a standard instrument of economic stabilization are of a political cum institutional nature.

i) History matters.

Does the country have an episode in its not too distant past when controls on foreign capital flows were put in place? If so, in which macroeconomic context were they applied? Was it in the midst of a balance of payments cum financial crisis or as a precautionary tool in conditions of overall stability? How and for how long were they implemented and when were they lifted? What is the current perception of the local entrepreneurial and financial community of the benefits, costs, and overall short and long-term effects of the CFM measures implemented?

Depending on the extent to which the nation´s experience with regulations of capital flows is associated with traumatic balance of payments crises, the polity may be inclined to reject a new attempt to apply them except in extreme conditions. Fear of creating destabilizing pressures on the domestic financial markets may be used as an argument against even the mere theoretical possibility of their use. In such cases, any move towards CFM requires the buildup of a consensus that the fiscal, monetary and financial fundamentals of the economy are strong and that the government´s development agenda is fully committed to preserving stability and a sustainable trajectory of public debt. This is a major technical and political challenge.

ii) Political Economy matters.

Even though CFM can strengthen a country´s prospects of stabilization and economic growth as a whole, its impact at the micro level may be highly variable. For certain economic groups whose financial operations are very much integrated in the global capital markets, CFM may be a severe disruption to their activities. What is being diagnosed by the monetary authorities as risky and unstable capital flows dynamics - and thus with a social need for their regulation - is contrarily seen by such groups as fair opportunities for portfolio adjustment. Restrictions on foreign capital flows may reduce expected profits and alter the business climate for the financial sector and certain foreign direct investors. This would inevitably create tensions among the business community and political actors.

Will the economic interests of certain private groups be strong enough to block or circumvent CFM? An historical example is, say, the last-minute intervention by New York bankers in the final draft of the IMF´s Articles of Agreement; an intervention that aimed at watering down proposals regarding CFMs put forward by Keynes and White. Recall too that, as stressed by Keynes, CFM would not be effective unless applied "at both ends"; from their source of origin to the country of destination. Intervening only on one "side" of is bound to be ineffective as "players" will find ways to circumvent any such controls. An illustrative example is the development of the FOREX market in England. Despite imposing controls on capital outflows, the 1950s and 1960s saw the birth and boom of the Eurodollar market in London partly as a result of a "loophole" in the regulations that permitted transactions on the forward exchange market (Schenk, 1998).

iii) The Productive Structure and Financial Architecture matter.

Both aspects should be considered when evaluating the convenience of introducing some form of CFM. Countries with sound domestic banking sectors may not find it particularly difficult to absorb the impact of the reduction of foreign capital inflows as a source of finance of their current account deficit. Others, in particular those lacking strong development banks, may find it impossible without facing acute shortages of financial resources, especially in hard currency.

It is crucial to identify how CFM might harm fixed capital formation, to identify which investment projects will most likely be affected by its introduction. If, say, foreign capital is mainly devoted to financing speculative asset purchases, CFMs may be more easily legitimized. In this regard, and incidentally not independent of the previous point on the significance of political economy considerations, it is fundamental to assess whether their implementation may lead credit rating agencies to downgrade the country´s sovereign debt. The adverse impact of such a measure on the country´s business climate and policy space may dwarf its potential benefits.

iv) The country´s institutional and legal context with the international community matters.

The institutional sphere is a key element to consider in the discussion on CMF. Whether the country has signed international agreements is crucial, as many such agreements discourage or even prohibit any policy intervention to restrict foreign capital outflows or inflows. They may prohibit what their partners see as, say, unfair exchange rate interventions to provide commercial advantage. Mexico, which recently signed the USMCA agreement with U.S. and Canada (replacing the original NAFTA signed in the mid-1990s) is an example. Despite having a sophisticated financial system – including a deep forex market and the second most traded currency in the developing world – it has been lately suspected of currency manipulation by the US. In fact, the U.S. Treasury recently placed it on its foreign exchange monitoring country list. This implies that the Mexican central bank is to be monitored to assess if it is manipulating its exchange rate to promote price competitiveness. If, say, found guilty of currency manipulation, application of pecuniary sanctions may proceed. In brief, given the USMCA, implementing CFM in Mexico would be rather difficult, not to say impossible.

As a final reflection to close this contribution, we welcome the enormous attention that has been paid in recent years by the academic community and international financial organizations to the examination of the technical aspects, and pros and cons, of implementing CFM. The vast literature developing in this direction has created, in our view, a consensus in favor of not only de-demonizing CFM but also of considering it as a legitimate tool of macroeconomic stabilization cum macro prudential policies; in other words as a tool to be used in "normal" times and not only in the face of balance of payments and financial crises. This is an important achievement. However we point here to the need to devote significant research efforts to identifying the non-technical factors that today condition - and sometimes impede - the implementation of CFM in the developing world. We have sketched four of them here, but certainly more in-depth analysis is required.

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[1] Universidad Nacional Autónoma de México, January 4, 2022

[2] See Minsky (2008)

[3] See, inter alia Ostry (2012), Ostry et al (2012), Zeev (2017)

[4] See IMF (2020)

[5] A most entertaining and illuminating description of this episode can be found in Diaz Alejandro´s 1985 article: Goodbye financial repression, hello financial crash".

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