

# Capital mobility in Russia

Natalya Ketenci

*Yeditepe University, Istanbul, Turkey*

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## Abstract

This paper investigates the level of capital mobility in Russia, testing the Feldstein–Horioka (1980) puzzle (FHP). The study examines relations between saving and investment flows in Russia in the presence of structural breaks. It employs the quarterly data for the period 1995–2013, in which all estimations are made for two periods: the full period 1995–2013 and 2000–2013, the post-Russian crisis period. The empirical analysis includes the Kejriwal and Perron (2008, 2010) structural break test to determine the presence of structural breaks in series and estimate the savings retention coefficient under the consideration of structural shifts. To facilitate comparison, the parameters of the model were estimated employing the OLS and FMOLS procedures. To test the cointegration relationships between investment and saving flows in Russia, two different cointegration tests were applied to the data. The first applied was the Maki (2012) cointegration test, which allows for an unknown number of breaks; then, in a case where only one break was detected, the Carrion-i-Silvestre and Sanso (2006) cointegration test was employed. The results of this study provide evidence of high capital mobility and reject the existence of the FHP in the post-Russian crisis period. Evidence of the cointegration presence indicates the solvency of a current account in Russia.

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## 1. Introduction

For the last several decades, economic crises throughout the world have been influenced by the rise of global financial integration. Numerous studies have been carried out to investigate capital mobility issues. The most popular concern

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*E-mail address:* [nketenci@yeditepe.edu.tr](mailto:nketenci@yeditepe.edu.tr).

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in capital mobility studies is to explain and solve the Feldstein–Horioka puzzle (FHP). Related to the seminal work of Feldstein and Horioka (1980), the FHP established that investment and savings ratios are highly correlated in developed countries and demonstrate low capital mobility. These findings contradict the expected low correlation between investment and savings ratios, particularly in the sample of the OECD developed countries. Since then, a great deal of the attention in the literature has been given to the FHP, with particular focus on European or OECD countries (see, for example, Fouquau et al., 2008; Giannone and Lenza 2008; Kollias et al., 2008; Apergis and Tsoumas, 2009; Kumar and Rao, 2011; Ketenci, 2012, 2013). Apergis and Tsoumas (2009) published the latest updated review of the literature related to the FHP. The authors conclude that the results of the majority of studies support a high correlation between savings and investments but at a lower level. Meanwhile, they indicate that most studies do not validate the capital mobility hypothesis.

For the last several decades, transition and emerging economies have experienced the liberalization process in trade and capital transactions. However, little attention has been given in the literature to transition and emerging economies, which increasingly are becoming important players in the global financial market (Fidrmuc, 2003; Misztal, 2011; Bose, 2012; Petreska and Mojsoska-Blazevski, 2013). These studies employ panel data obtaining mixed results, whereas transition and emerging countries are highly heterogeneous. Moreover, they do not include Russia in panel samples. One reason for this is its large population compared with the estimated countries, which would significantly affect the average estimations and distort the results (Peterska and Mojsoska-Blazevski, 2013). Some authors have included Russia in their comparisons, some of which have been panel studies on the FHP (Aristovnik, 2005; Özmen, 2005; Jamilov, 2013; Trunin and Zubarev, 2013). However, the issue of capital mobility measurements in Russia has not been sufficiently investigated in the literature.

With a population of 143.5 million, Russia is one of the ten most populous countries in the world. In 2012, the GDP of Russia was 2.015 trillion USD, which represents 3.25% of the world economy, putting it on the list of the ten largest world economies.<sup>1</sup> The investigation of capital flows of Russia is not only important at the regional level but on the global level as well. However, there is a lack of studies on capital mobility and its measurement in Russia. Russia is still behind most advanced countries in terms of free capital mobility; however, it is in front of other emerging countries, such as BRICS<sup>2</sup> (see, for example, Fig. 1).

Since the transition began, the capital liberalization policy for capital accounts has been cautious and gradual in transition countries, where non-FDI-related transactions have been restricted. However, Russia has had a different program for capital liberalization compared to that of the Commonwealth of Independent States (CIS), which started the process of transition at the same time. The liberalization of FDI transactions has been executed under strict limitation with gradual ease. Restrictions on nonresident portfolio investments were gradually removed

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<sup>1</sup> World Bank.

<sup>2</sup> BRICS — Brazil, Russia, India, China and South Africa.

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