Charles Goodhart's career has alternated between academia (Cambridge, 1963–65; LSE, 1967/68; again 1985-date), and work in the official sector, mostly in the Bank of England (Department of Economic Affairs, 1965/66; Bank of England, 1968–85; Monetary Policy Committee, 1997–2000). He has been a specialist monetary economist, focussing on policy issues and on financial regulation. He authored numerous publications on monetary policy and 'Goodhart's Law'.

Charles Goodhart

The direction of global capital flows

Poor, emerging economies generally have an excess of labour, but a shortage of capital. In such conditions, the return from capital inflows from abroad should be high. But the restriction on inward foreign investment does not relate so much to the prospective return, if everything goes well, but rather to fears about the corruption and incompetence of government and fears whether it is focussed unduly on benefiting a particular segment of its people, i.e. that it is not fair. Effective, fair and incorrupt government is crucial. Some authoritarian governments have been competent and relatively fair and free of corruption, particularly in Asia, such as Singapore and China, and now, hopefully, Vietnam. Such competent authoritarian countries have succeeded in bringing millions out of poverty, with the growth of China being the most successful example of a shift from poverty to a reasonable standard of living. There is also a question of how one defines 'authoritarian' and, indeed, 'democratic'. Both Russia and Turkey hold elections; would they be described as 'democratic' or 'authoritarian'? Again, many countries in Sub-Saharan Africa hold elections, but the change of power is often by a military coup. It is true that there are bodies that seek to assess the degree of democracy, but their rankings can, and would be, challenged if any money rode on the results.

Let me now look at the issue of trying to influence the direction of international capital flows from the point of view of the lender. If the lender is an individual, in my view, she should be allowed to use whatever criteria for such investment that she might want. I do not have access to the relevant data, but I would expect that the share of international capital flows done by individuals to be relatively small. They do not have sufficient access to information about other countries, so there is a great degree of home bias.

So, most international capital flows done by the private sector will be undertaken by various financial intermediaries, of one stripe or another, pension funds, insurance companies, asset management companies, etc., etc. They have an obligation to their clients to achieve the best risk/return combination that they can achieve. While the international direction of their investment could be influenced by external regulation or subsidies/ taxes, it would seem inappropriate to suggest that they have any other objective than that set out above.

That leaves government, and governments individually do a limited amount of international transfer of funds, by foreign aid, etc. But governments in turn are responsible to their electorate and would normally intend to direct their funds where they think it could provide most benefit to their own people, via support of friendly countries and those that will import from them. That leaves the multilateral institutions, the World Bank, IBRD and IDA. There is a strong moral case for countries providing further resources to these bodies, but this is limited by those whose main objective is to 'Make My Country Great Again'.

I have not looked either at the amount, or the country distribution of loans from these bodies, but I would expect that their criteria involve considerable weight on the competence and fairness of government, and rather less on whether it is democratic or authoritarian, but you might want to look. In any case the voting pattern, and outside control, of the multi-lateral institutions tends to be dominated by democratic, rather than authoritarian countries; thus China has a lower share and the USA a larger share in voting rights in the World Bank, than their relative economic and population sizes would suggest; and the World Bank is sited in Washington.

Certainly, this is not to say that the form of government is not important; it is clearly extremely important. But that said, for economic purposes, what is even more important is whether that government is competent, fair and without corruption.