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Domestic Crony Capitalism and International Fickle Capital: Is There a Connection?†

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Abstract

Domestic crony capitalism and fickle international capital flows are often suggested as two *rival* explanations for currency crises. This article examines a possible linkage between the two that has not been explored much in the literature: domestic crony capitalism may make a country more dependent on the more fickle type of international capital flows (e.g. international bank loans) rather than the less volatile type (e.g. foreign direct investment). It presents statistical evidence that the degree of domestic crony capitalism is indeed associated with a higher external loan-to-FDI ratio. Such a composition of capital flows has been identified as being associated with a higher incidence of a currency crisis. Therefore, even though crony capitalism does not forecast the exact timing of a crisis, it can nevertheless increase its likelihood.

Citing Literature

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