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The growth effects of capital flow liberalization in Central and Eastern Europe

At the beginning of the 1990s, the Central and Eastern European (CEE) countries started both the transition from a centrally-planned to market-based economies and the integration with the international financial markets. One of the first steps was to establish the current account convertibility in order to lift restrictions on foreign trade transactions. The aspiration of the CEE countries to join OECD and EU played an important role in opening up to the cross-border flows of capital. Despite the fact that in the 1990s there was a common view among economists and international organizations that capital flow liberalization is beneficial for the emerging market economies, the CEE countries did not take an uniform approach to this process. The speed and sequencing of liberalization of the financial account transactions were determined mainly by their the initial economic conditions and pace of economic re-forms.

The paper analyzes the experiences of the CEE countries in terms of capital flow liberalization and attempts to answer the question whether there is a positive long-term relationship between financial integration and economic growth. Firstly, it describes the process of the removal of barriers on cross-border capital flows in the analyzed group of countries over the past two decades. Secondly, it provides a literature review on the growth effects of capital flow liberalization. Finally, it tests empirically the working hypothesis using data for selected CEE countries, running a GMM and IV panel regressions.

JEL codes: C23, C26, E44, F21, F30, F43, O1.

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