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Financial Globalization

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Abstract

The paper studies how global financial markets can be restructured so as to be more stable while also providing some national economic autonomy. An impossibility theorem sets the stage for the analysis of reform alternatives. Then, the relative merits of alternative exchange rate regimes and of different degrees of capital-market-flow regulation are considered. The paper concludes by opting for a combination of : floating exchange rates; slowing down and taxing foreign capital inflows; and greater national economic sovereignty.

Introduction

Globalization of financial markets affects assets and debts—securities, bank loans and deposits, titles to land and physical capital. Let me start by noting that trades in these assets and debts are much easier to globalize than trades in commodities and labor. Indeed, their globalization has progressed most rapidly. Nothing is involved in financial transactions beyond exchanging pieces of paper or making entries in electronic ledgers. The communications revolution makes these transactions easy, fast and cheap. No physical frontiers have to be crossed by financial assets. The only barriers to financial transactions are national regulations. As these have been liberalized in country after country, international financial flows have flooded national securities markets and inundated banking systems all over the world. These flows could be the vehicles by which savings in the advanced capitalist democracies are channeled into productive capital investments in the developing countries of Asia, Africa, and Latin America. Or they could be causes of currency crises, recessions and depressions, unemployment and deprivation in those countries. Or both.

The economic rationale for internationalization of asset markets is that it can assist the movement of productive capital from wealthy developed economies to poorer developing countries. But what matter are the net flows of capital, not the gross volume of transactions. The emerging economies of East Asia, as well as some in Latin America and Eastern Europe, are beneficiaries of foreign business investments. But much of their capital inflows have taken the form of short-term loans of hard currencies from banks in financial centers such as Tokyo, New York and Frankfurt to banks in Korea, Thailand and Indonesia. The periods of increasing loans were also periods of increasing growth and investment in countries receiving the loans; however, they were also, necessarily, accompanied by increasing overvaluation of national currencies and growing deficits on current account. Crises came when the lenders, viewing the growing deficits, became distrustful and refused to renew the loans.

Are the benefits of financial globalization likely to outweigh the costs? One hint can be obtained by comparing the magnitudes of gross and net capital transfers. Although developing countries have increasingly benefited from inflows of capital, the investments that have propelled their growth have been mainly due to their own internal savings. Capital flows from the world economic core to the periphery, only $150 billion a year in the 1990s, have been less than 15% of their investment and less than 5% of the savings of the developed capitalist economies. These shares are much smaller than comparable figures before 1914, when they were both close to 50%. By contrast, the worldwide gross volume of foreign exchange transactions is mind-boggling: US$1.5 trillion per business day and growing rapidly. Nine-tenths of these transactions are reversed within a week, 40% within a day. Clearly, most of these foreign exchange transactions are speculative. These numbers show that the gross volume of foreign capital flows dwarfs the net capital transfers.

It is only the net capital transfers that carry the economic benefits globalization is advertised to bring. It is the gross, speculative transactions which carry with them the destabilizing effects leading to financial crises and severe real economic downturns.

The 1990s have been a decade of disturbances in international finance, beginning in Europe in 1992, followed by Mexico in 1994–95, climaxed by East Asia in 1997–98, Russia and Brazil in 1998. Is the problem that liberalization in developing and transition economies is still incomplete? Or has it gone too far? Is there a way of restructuring global financial systems so that the benefits of long-term foreign investment will be preserved while speculative flows will be discouraged. That is the big debate today.

Section snippets

Types of reforms of financial systems

Most observers, West and East, public and private, in governments and international institutions, in banks and businesses, in big countries and small, now agree that financial globalization went too far too fast.…

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2022, Journal of International Financial Markets, Institutions and Money

> *Citation Excerpt :*
> …In particular, financial flows have spread around the world, since financial assets such as securities, bank loans and deposits are much easier to globalize than commodity and labor trades. In addition, most international capital flows have taken the form of short-term loans between banks (Tobin, 2000). Furthermore, the "capital flight" effect also strengthened the interdependence of financial markets between different regions (Broner and Ventura, 2016).…

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