GLOBALIZATION AS FINANCIAL CRISES PREMISE

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Abstract

Financial globalization represents an important form of economic globalization and is a process of interconnection of basic segments of financial markets at national and international level. It is expressed through increasing the volume and intensity of financial flows, which is determined by opening of national financial markets, level of financial leverage and financial integration. Also, it is aggregated form of international financial integration, which refers to increasing global connections created through cross-border financial flows. The carried out research demonstrate, that certain basic features of financial globalization are in fact prerequisites for triggering international financial crises. The amplification of financial globalization increases the instability in the international financial system and the probability of international financial crises. Knowing this allows the facilitation of predicting international financial crises and reducing their contagion effect.

Keywords: financial globalization, financial crisis

JEL classification: G01, G15

Introduction

Globalization is a process in which the world is transformed into a single global system. From the economic point of view, globalization leads to transforming space into a unique world where information, goods, services, capital flow freely.

Yeyati and Williams (2011) define financial globalization as "global linkages through cross-border financial flows that has become increasingly relevant for emerging markets as they integrate financially with the rest of the world".

Financial globalization concept aims to create an open global market, global financial markets, global financial system, whose appearance and development is based on the phenomenon of deregulation of national financial markets, the emergence and development of new financial instruments and banking and other international financial institutions activity expansion.

Financial globalization requires greater volume of financial flows of capital and increases of their intensity. The size of these processes can be proportional to the degree of openness of national financial markets, level of financial leverage and financial integration.

Russian investigator Evlahova (2007) points to some basic features of financial globalization:

1. Financial globalization is a part of economic globalization, which is presented by deepening interdependence of worldwide countries through increasing volume of cross-border transactions, services and capital, rapid and broad dissemination of technology.

2. Financial globalization became the dominant form of economic globalization. It was found that the capital is one of the most mobile factors of production, which moves quickly in search of profit. This process was catalyzed by the liberalization of capital movement. An important role in increasing capital mobility had information revolution manifested not only through the implementation of a variety of media and information technologies, but also the creation of new capital flow channels (Internet).

3. Financial globalization has changed the structure and composition of global economic problems, has advanced the dominant role of transnational companies and banks and has reduced the role of nation states and international financial institutions, stressing the incompatibility of tasks set by the imperatives of the new global economy. It requires the transformation of national financial systems

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under the influence of financial globalization. One consequence of these changes was the loss of many regulatory instruments by the state and reduction of monetary and fiscal measures effectiveness.

From elsewhere, in general approach, the financial crisis is the situation where money demand is greater than supply (availability) of money. This means that liquidity is rapidly evaporated because available money is withdrawn from the banks, thus forcing banks to sell their assets or investments and to cover their needs, or to collapse. *(Criza financiară, n.d.)*

According to the Romanian scientist Paun (2008), financial crisis is only a manifestation of the economic crisis and reflects a confidence in the financial system increased volatility in the capital markets, a significant decrease in transactions volume on the stock exchange, a disorder of market mechanisms.

Claessens and Kose (2013) associate a financial crisis with "one or more of the following phenomena: substantial changes in credit volume and asset prices; severe disruptions in financial intermediation and the supply of external financing to various actors in the economy; large scale balance sheet problems (of firms, households, financial intermediaries and sovereigns); and large scale government support (in the form of liquidity support and recapitalization).

Scientists Reinhart and Rogoff (2013) consider the period 1900-2010 as very specific in order to study international financial crises (Figure 1).

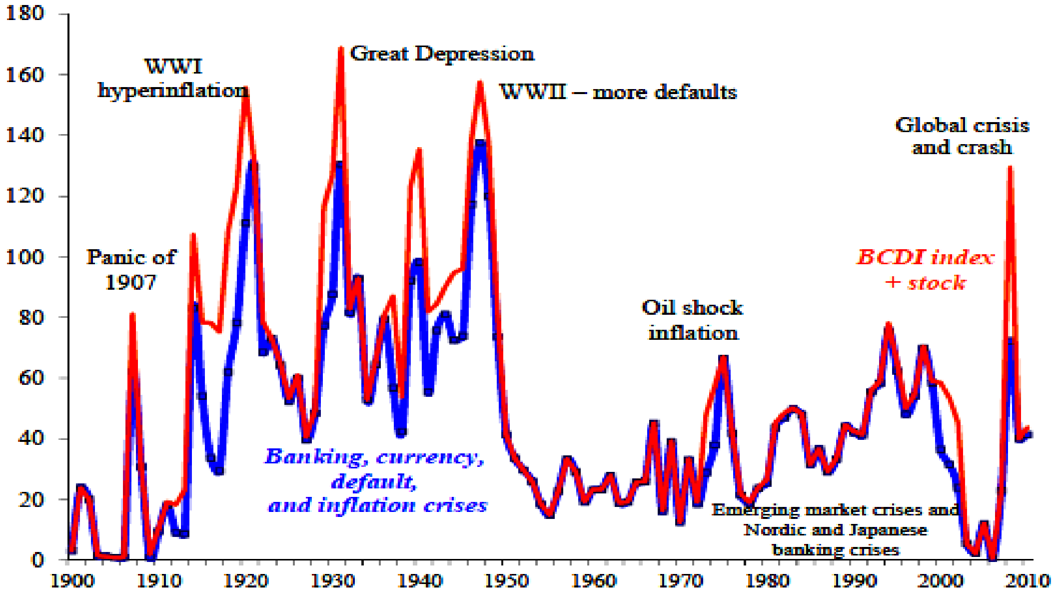

Fig.1. *Varieties of Crises: World Aggregate, 1900–2010*

Source: Reinhart and Rogoff (2013)

The last international financial crisis of 2007–08 (also called Global Financial Crisis) was the worst financial crisis since the Great Depression of the 1930s. *(Financial crisis, n.d.)*

Description of the problem

Financial globalization is now able to gain the ever-increasing flow of funds. Going beyond national restrictions, financial capital contribute to the financial globalization and it ranks the driving force of the overall process of globalization.

At the same time, increasing globalization leads to enormous financial risks in the international financial system, giving it a substantial instability and uncertainty. The result of this instability is fructifies in the form of international financial crises, which, in turn, showed the imperfection of the current global financial architecture.

The actuality of the study is determined by continuous exposure of the national economy from different countries to the impact of financial globalization factors, creating different gender issues and provides additional opportunities. Addressing the first and taking advantage of the latest is a primary task.

Methodology and data sources

Research carried out in the first place was based on the financial globalization and descriptions of international financial crises triggering during XX and XXI centuries contained in various bibliographic sources. After was examined the existing theoretical concepts and analysts comments on financial globalization and international financial crises. Following was performed generalization and synthesizing of basic ideas and formulate hypotheses on connection between both categories, which were tested with the public databases dialing accessible specialized sites on the Internet. Obtained results were presented in this article.

Results obtained

Conducted research shows the impact of financial globalization on the triggering of financial crises can be considered on the basis of a certain characteristic phenomena, which, on the one hand, are creatures of financial globalization, and on the other hand, are factors that increase the likelihood of financial crises. They are the following:

- deregulation (liberalization) financial markets and institutions and reducing the regulatory authority and monitoring capacity of domestic and international regulators on financial markets;
- cross-border capital flows increasing;
- accumulation of substantial funds in a number of specific areas, free from the control of national legislation and supranational regulators;
- global systemic risk amplifying.

For starters, in our opinion, should be mentioned *deregulation (liberalization) financial markets and institutions and, as a consequence, reducing the regulatory authority and monitoring capacity of domestic and international regulators on financial markets*.

Kallianiotis (2011) affirms that one of the causes of financial crisis of 2007–08 was the deregulation in the U.S. financial markets and institutions which contributed to increasing of lending, corruption, speculation, financial and real assets (even in food) prices and enormous bubbles creation.

Already in the late 1980s related studies indicate that rapidly proceeded deregulation increased the volume of purely financial transactions which now greatly exceeds international trade in goods and services. This new pattern led to economic uncertainty and instability deepening. (Versluysen, 1988)

Russian scientist Sen'kov (2012), in his turn, states that liberalization of economic legislation and state controls reducing significantly limit the possibility of national regulatory institutions to influence the situation on financial markets. Financial globalization impact reduces the ability of national regulators to amend the policies of major players in the financial market, such as multinational corporations and transnational banks. Supranational regulators also have a insufficiency of effective instruments of influence on financial market participants activity.

Financial globalization contributes to erosion of legislative distinction between different types of financial activities wich enables the emergence of financial institutions. As a result, a big number of financial companies operating in the same time in most segment of financial market. This process leads to a significant exasperation of systemic risk, as the bankruptcy probability of a major financial institution which in turn can cause instability in a number of markets. (Sen'kov, 2012)

An additional problem in this context is to promote financial market innovative process both nationally and internationally as a basic feature of financial globalization. Recent research shows that in the absence of effective regulation, financial innovation becomes a factor for financial crisis triggering. (Klein, 2010)

Concern economic analysts finds, an important consequence of financial globalization is the spread of securitization of banking activities and the use of derivatives wich make financial transactions much more complicated and lost of transparency. Frequently it is not always possible to evaluate assets which underlie traded securities. (Sen'kov, 2012)

Moreover, world derivatives market is tranformed now in the largest financial bubble. In 2008 the market volume constituted $600 trillion (Barrett, 2008). In 2010 it increased to $1200 trillion (Cohan, 2010) and for 2015 the forecast is $1500 trillion (Snyder, 2014). If this bubble will finally burst, it will be a complete disaster for the financial system of the planet.

The next aspect of financial globalization, which is to be examined, is *cross-border capital flows increasing.*

But, from other hand, Broner, Didier, Erce, Schmukler (2013) demonstrated that some international capital flows have played an increasingly important role in the business cycles of high-income and middle-income countries, especially since the 1970s and during episodes of financial crises. Gross capital flows are more an more larger and volatile. In compliance with those authors, gross capital flows are pro-cyclical. Capital flows tend to increase during expansions and to decrease during economic downturns. During crises, total capital flows collapse because of retrat of investors from foreign markets.

International Monetary Fund experts indicate on costs of international capital mobility as factor of financial crisis (Wang Xiaoyi, 2013):

- Large-scale capital inflows could affect the independence of monetary policy, increase money supply and in turn add to inflationary pressures and create asset bubble risks.
- Capital surplus can aggravate balance of payments distortions and currency appreciation pressure.
- Large-scale capital outflows could have negative effects on a country's international credit rating, undermine investor confidence and lead to currency devaluation pressure and balance of payments deficit risks.
- Large movements of short-term speculative capital could endanger financial stability.

Additionally, in our view, an important issue is cross-border capital flows orientation towards the formation and amplification of speculative bubbles and massive withdrawal of investors funds cause their breakage and financial crises triggering.

Data presented by McKinsey Global Institute demonstrates the amount of cross-border flows tend to increase on the verge of financial crisis. Thus, they have achieved 4,9 trillion in 2000 and 11,8 trillion USD in 2007. But the onset of the international financial crisis, the value of cross-border financial flows tends to fall sharply. (McKinsey, 2013)

This regularity is confirmed by Figure 2 which also shows the structural dynamics of cross-border capital flows.

That trend takes place for all type of cross-border capital flows, but their stability level is different.

Becker Chris, Noone Clare (2009) remark that foreign direct investments and reserves have come to be viewed as being relatively stable. In contrast, portfolio investments and bank and money market flows are considered as speculative (also called *hot money*) and subject to sharp reversals, thereby being treated as a factor financial instability.

In this context it may be referred to the phenomenon of *capital flight* (as symptom rather than a cause of financial crisis) expressed by widespread currency speculation linked with cross-border movements of funds that affect national financial markets. Frequently capital flight can be caused by expectations of devaluation of the home currency and can become self-fulfilling, as depletion of the central bank's reserves force it to devalue. In that way capital flight becomes a source of financial instability. (Darryl)

Figure 3 shows the structural dynamics of cross-border capital flows in deographical distribution section. In the 1990s and up to 2008 advanced economies ensured at least 75% of gross capital flows before the crisis, and roughly 60% after the crisis. The role of emerging countries in gross capital flows has been rather limited.

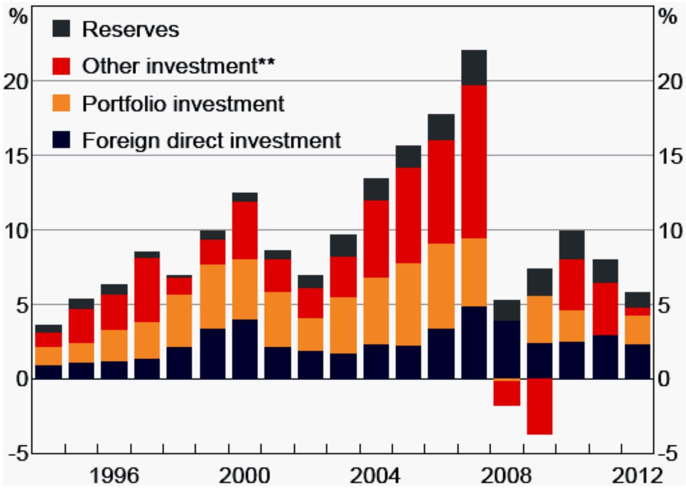

Fig.2. *Global Capital Flows (Per cent of GDP, annual)*

Source: (Elliott, McLoughlin, Rankin, 2014)

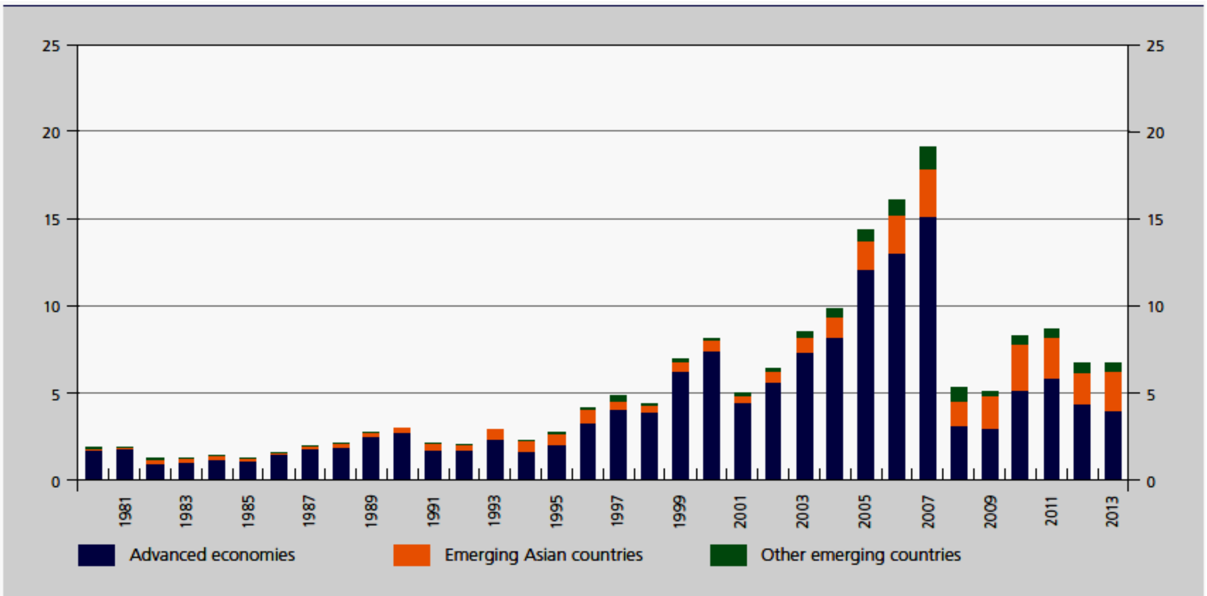

Fig.3. *International gross capital flows (in % of global GDP, sum of inflows and outflows)*

Source: (Butzen, Deroose, Ide, 2014)

Another feature of financial globalization is *accumulation of substantial funds in a number of specific areas, free from the control of national legislation and supranational regulators*.

Globalization implies international network of financial centers expanding, a leaner system dominated by a handful of strategic cities being evolving. Financial operations disperse around the world, but only a few cities have enough resources to be dominant. (Sassen Saskia, 1999)

A global financial centre is a city with a large number of internationally significant banks, businesses, and stock exchanges. An international financial centre is a non-specific term usually used to describe an important participant in international financial market trading. An international fi nancial centre will usually have at least one major stock market. (Fetiniuc, Luchian, 2013)

Financial globalization progressed with increasing market capitalization and liquidity in a small number of large financial centers. Its financial activity was essentially concentrated in the large financial centers. (Das, 2010)

At the moment in the world there are 82 international financial centers, but, as first, According to the 2014 Xinhua-Dow Jones International Financial Centres Development Index, can be mentioned New York, London, Tokyo, Hong Kong and Singapore. (Financial Centre*, n.d.*)

But in the context of the globalization and financial crises is required also to examine activity offshore financial centers.

According Rose-Marie Belle Antoine, they can be defined as regimes which has chosen as a main or important path to development, legislative, financial and business infrastructuree which is more flexible than orthodox infrastructure and which cater more specifically, and often exclusively, to the needs of non-resident investors this legislative framework includes innovations in trust, banking, fiscal, insurance, financial and company law. (Offshore, n.d.)

Offshore financial centers activity becomes a serious problem for global financial stability with the growth of financial flows served by these entities and the massive increase of stored financial assets, which tends to exceed the overall volume of financial reserves and are free of any official control.

Recent studies show some data that characterizes them:

- The IMF estimated in 2010 that small island financial centres alone contribute $18 trillion, which is equivalent to around a third of the world's GDP. (Jakopovich, 2013)
- The world's fifth largest financial centre, hosting over three-quarters of the world's hedge funds, and $1.9 trillion on deposit – four times as much as in New York City's banks. (Jakopovich, 2013)
- Tax Justice Network (2014) estimated that the stock of financial wealth held offshore, hardly taxed or untaxed and in substantial conditions of secrecy amounts to some $21-32 trillion.
- Global Financial Integrity estimated that in 2012, $991.2 billion left developing countries in illicit financial outflows, of which about 45% end up in offshore financial centers. (*Illicit, n.d.*)

Palan and Nesvetailova (2013) drew attention on the phenomenon of *shadow banking* - a complex network of financial intermediation that takes place outside the balance sheets of the regulated banks, and thus remains invisible to the regulatory bodies.

Since the crisis erupted in 2007, research into shadow banking has progressed quite rapidly. The Financial Stability Board put the global size of the shadow banking system at around $67 trillion in 2012 and at $71 trillion in 2013 (*Global, n.d.*).

Shadow banking activity is linked to an important dilemma (Nesvetailova, 2014). On the one hand, today shadow banking is a vital part of financial activity, helping banks meet liquidity needs, conducting securitization and lending functions and accommodating a variety of economic interests, from investment banks and pension funds to high-net worth individuals and sovereign wealth funds. But on the other hand, shadow banking raises at least three inter-related problems:

- Many visible banks are able to enlarge their de facto size, often creating undetected leverage and thus, adding to the problem of "too big to fail."
- Netting several entities into opaque chains of credit intermediation, the shadow banking system amplifies the scope for regulatory arbitrage.
- Shadow banking obscures the sources and real dimensions of systemic risk in the financial system and aggravates the problem of non-transparency of finance.

Another problematic feature of financial globalization is *global systemic risk amplifying.*

It's about of systemic risk in securitized globalized markets, wich is created by unexpected events that heighten uncertainty sharply and impair market liquidity. The last may lead to price collapse in individual markets and in the pricing of specific assets. Following caused stress waves extends to the funding liquidity of financial institutions across the globe that are supporting those individual markets. Market illiquidity can lead to significant real economic effects. (Lipsky, 2009)

Gianni De Nicolò and Luciana Juvenal (2010) have demonstrated the link between financial integration, globalization and systemic risk. Following the logic of obtained results, we can highlighte three basic channels:

- Increasing integration of domestic financial markets and international, through proportions, mobility and global financial market volatility;
- Increasing dependence of financial integration and global financial market liquidity through the core segments;

- Examination of institutions quality and corporate governance as important determinants of the levels of financial integration and globalization.

Conclusions

Performed analysis confirms the dependencie between financial globalization deepening and international financial crises triggering. In this context it is deregulation (liberalization) financial markets and institutions and reducing the regulatory authority and monitoring capacity of domestic and international regulators on financial markets, continued growth of cross-border capital flows increasing, accumulation of substantial funds in a number of specific areas, free from the control of national legislation and supranational regulators, global systemic risk amplifying. Therefore tracking of global financial processes permits the prediction of the global financial crisis. It also permits to improve the international financial system regulation and domestic financial policies adaptation to new realities.

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