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BENEFITS AND RISKS OF FINANCIAL GLOBALIZATION FOR DEVELOPING AND EMERGING COUNTRIES

The crucial features of world civilization contemporary development under the influence of globalization are clarified; the benefits and risks of this process for developing and emerging countries are identified in the article. The state of Ukrainian economy in the context of globalization processes is analyzed. Levers for reducing the negative impact of globalization on the development of national economy are proposed.

Key words: globalization, world economy, national economy, economic integration, developing and emerging countries.

The increased interdependence among countries through the deepening of trade linkages in goods and financial assets, spurred by the so-called process of globalization, has paid attention of economists, attracting both strong supporters and opponents.

Supporters believe that globalization offers extraordinary opportunities to spread across the world advanced technology, solving economic and social contradictions, and therefore need to speed up the introduction of a new economic order, primarily through financial markets, loans, investments, global firms, information technology [1].

The other position is based on absolutization those potential negative effects that brings globalization. Followers call for any containment of this process, finding ways to protect against it [2]. As economies become more integrated, governments have less policy instruments and have to rely more on international financial policies. For example, governments tend to have fewer options about their monetary policy and exchange rate policy. In Ukraine is observed a higher transmission of international interest rates and prices to the domestic economy. Moreover, bank regulation and supervision by one government is more difficult when liabilities and prices are denominated in foreign currency and when the banking sector is part of an international banking system. Also, in the midst of contagious crises, governments tend to lack sufficient resources to stop a currency attack and individual government can do little to stop crises being originated in foreign countries.

In these cases, the interest in understanding and influencing on the global processes is increasing. So our main **goal** of this article is clarification the crucial features of world civilization contemporary development under the influence of globalization, to identify the benefits and risks of this process for developing and emerging countries for further designing financial policies and the ways of adapting the countries' economies to globalization process.

It is by now almost impossible to imagine a world without a global financial system. Professor Kenen affirms that «most middle-income developing countries, even some that still have capital controls of one sort or another, are increasingly integrated into that system, and all of the major developed countries are fully integrated» [3]. Furthermore, not only more and more countries involved in the global financial system, the degree of country-development synchronization has changed over time in response to growing global linkages, which change the importance of common vs. country-specific shocks.

Many scientists [3-8] examine the implications of globalization, which is often associated with increased international trade and financial linkages, for the synchronization of international business cycles.

Economic theory has ambiguous predictions about the impact of increased trade and financial linkages on the comovement amongst macroeconomic aggregates across countries. Some economists hold the opinion that stronger trade linkages can lead to higher or lower degree of comovement depending on the nature of integration and the form of specialization patterns [4].

Crisis infection in the general sense is the process of market fluctuations transmission from one country to another, resulting in simultaneous changes in exchange rates, interest rates, prices of stocks and flows of capital [9].

Analysis of numerous scientific papers devoted to this problem, allows selecting several different scientific approaches concerning the mechanisms of spread the crisis infection. Consider each of them in more detail.

The first one is based on the fact that countries with similar macroeconomic and financial indicators and features of the economies functioning are equally vulnerable to crisis. Crisis that begins in one country is easy disseminating to the other. This view is represented, for example, by J. Sachs, A. and A. Velasco, A. Tornell. They showed a significant dependence of crises emergence from internal factors such as overvalued real exchange rate, a weak banking system and low international reserves [10]. However, this approach is rather an auxiliary in the current situation, because in a lot of further researches it was determined that the international spread of financial crises depends more on trade and financial relations than on analogies in macroeconomic characteristics of the studied economies. Nevertheless, in our view, this approach illustrates a possible basis for sharp and simultaneous shifts in investors and creditors estimation about the creditworthiness of countries within a region in condition that in one of them started the financial crisis.

The second approach is based on the thesis that crises are spread through trade relations between the countries with the help of so-called «competitive devaluation» [11, 12]. The devaluation of the currency of one country automatically reduces the competitiveness of products of other countries with which the country competes in third markets, and thus to reduce their export earnings, that creates a downward pressure on their own currency. It works for any two countries linked by close trade relations – the currency depreciation of the one of them through the same mechanism brings to devaluation pressure on the currency of another. Because of the greatest intensity of trade relations observed at the regional level, the effect of competitive devaluation can explain the regional nature of currency crises.

However, the explanation of real examples of international spread of crises through the mechanism of competitive devaluation faced with several factors:

– this mechanism is fundamentally unfit to explain the spread of crises among countries that haven't intensive trade relations;

– effect of this mechanism is rather slow and can not explain cases of super quick spread of the crisis.

Therefore, the attention of the crisis infection researchers focused on approaches that examine the relationship between financial and behavioural aspects of international financial markets as a channel of distribution of unfavourable economic fluctuations. The spread of crises through financial linkages between countries is the result of interrelated mechanisms:

– losses in the crisis stricken country may force international banks to sell assets to other countries to restore their capitalization [8];

– a sharp increase of risk in credit portfolio in a country under the crisis causes international investors to reduce the total risk of their portfolios by reducing assets with a high degree of risk and the markets that historically have a strong correlation with the market affected by the crisis [6];

– lack of liquidity in the financial intermediators, as a result of the crisis in one country may cause necessity to sell assets in other countries [13].

The effect crisis infection transfer is closely associated with the phenomenon of information asymmetry and market it generated psychological aspects of financial markets behaviour, as well as the effect of moral hazard.

However, both classical and «new» trade theories imply that increased openness (trade linkages) to trade leads to increased specialization [14]. The nature of specialization (intra vs. inter-industry) and the types of shocks (common vs. country-specific) affect the degree of synchronization. If stronger trade linkages are associated with increased inter-industry specialization across countries, then the impact of increased trade depends on the nature of shocks. If industry-specific shocks are more important in driving business cycles, then international business cycle comovement is expected to decrease. If common shocks, which might be associated with changes in demand and/or supply conditions, are more dominant than industry specific shocks, then this would lead to a higher degree of business cycle comovement.

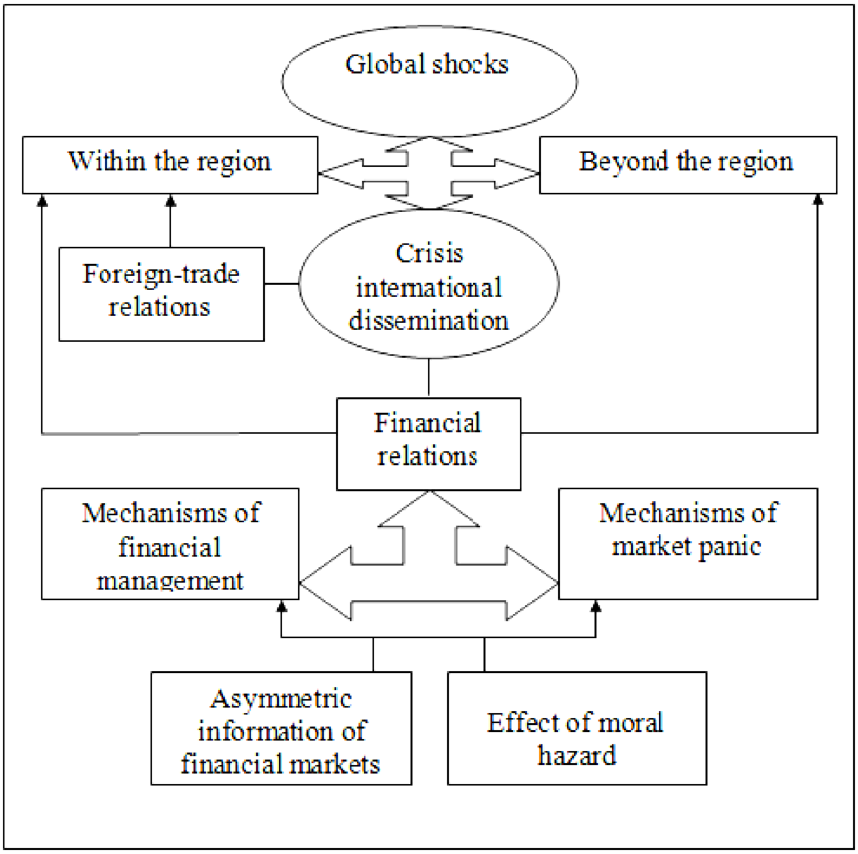

Fig. 1. Mechanisms of spreading the international crisis infection

Because of increased synchronization during the period of crises globalization can be associated with contagion. This is inescapable in a world of asymmetric information and imperfect contract enforcement [15]. Investigation into the issue of synchronization degree of progress between developed and developing countries haven't been conducted. Though many crises in developing countries are triggered by domestic factors and countries have had crises for a long time (even in periods of low financial integration), it is the case that globalization can increase the vulnerability of countries to crises. In open economies, countries are subject to the reaction of both domestic and international markets, which can trigger fundamental-based or self-fulfilling crises. Moreover, the cross-country transmission of crises is characteristic of open economies. Completely closed economies should be isolated from foreign shocks. But when a country integrates with the global economy, it becomes exposed to contagion effects of different types and, more generally, to foreign shocks.

There is also some evidence on the positive impact of financial liberalization on output growth. Bekaert, Harvey, and Lundblad estimate that output growth has increased about one percentage point following liberalization [17]. Although financial liberalizations further financial development, they show that measures of financial development fail to fully drive out the liberalization effect. Furthermore, Tornell show that financial liberalization leads to higher average long-run growth even though it also leads to some crises and to boom-bust cycles [18].

Financial globalization can help improve the functioning of the financial system in developing and emerging countries through two main channels:

1. financial globalization can increase the availability of funds;
2. financial globalization can improve the financial infrastructure, what can reduce the problem of asymmetric information.

As a consequence, financial globalization can potentially decrease adverse selection and moral hazard, enhancing the availability of credit. Regarding the first channel, in a financially integrated world, funds can flow freely from countries with excess funds to countries where the marginal product of capital is high. In this context, both foreign institutions and individuals might provide capital to developing and emerging countries if they expect these countries to grow faster than developed economies. As a consequence, countries can smooth consumption and make investments financed by foreign capital. This flow of capital from developed to developing and emerging countries is reflected in the large current account deficits typically observed in many developing nations.

The effects of capital flows on financial development take place because new sources of funds and more capital become available. New sources of funds mean that borrowers not only depend on domestic funds, they can also borrow from foreign countries willing to invest in domestic assets. The capital available from new sources means that market discipline is now stronger both at the macroeconomic level and at the financial sector level, as now local and foreign investors enforce market discipline on private and public borrowers. Foreign capital is particularly effective in imposing this kind of discipline given its footloose nature; foreign capital can more easily shift investment across countries. Domestic capital tends to have more restrictions to invest internationally.

An improved financial sector infrastructure means that borrowers and lenders operate in a more transparent, competitive, and efficient financial system. In this environment, problems of asymmetric information are minimized and credit is maximized.

In theory, there are different ways through which financial globalization can lead to improvements in the financial sector infrastructure:

1) financial globalization can lead to a greater competition in the provision of funds, which can generate efficiency gains;
2) the adoption of international accounting standards can increase transparency;
3) the introduction of international financial intermediaries would push the financial sector towards the international frontier;
4) financial globalization improves corporate governance; new shareholders and potential bidders can lead to a closer monitoring of management;
5) the increase in the technical capabilities for engaging in precision financing results in a growing completeness of local and global markets;

6) the stringent market discipline imposed by financial globalization has consequences not only on the macro-economy, but also on the business environment and other institutional factors [20]. Foreign bank entry is another way through which financial globalization can improve the financial infrastructure of developing countries.

Severity of the crisis in Ukraine has the objective conditions of an economic nature and is a consequence of specific political factors. Among the objective factors that increase the vulnerability of the Ukrainian economy a crucial role plays reduced sustainability potential. Ukraine's economy is not fully reformed, and therefore is low adaptive. It reduces the ability to counteract the development of the crisis. The evidence suggests that, in the long run, volatility tends to decrease following liberalization and integration with world markets, probably thanks to the development of the financial sector [16].

Integration of the Ukrainian economy into the global economy is accompanied by significant increase in foreign trade. Only in the last 10 years foreign trade turnover of Ukraine has increased more than 3 times. This is despite the significant reduction of external trade turnover, which was observed until 1999, foreign trade turnover today is over 80% of Ukraine's GDP. At the same time, foreign investment increased almost 40 times since 1996. The growth of this index is almost 20 times higher than GDP growth. At the same time financial globalization leads to the improvement of the financial system in developing countries. A well functioning financial sector provides funds to borrowers (households, firms, and governments) who have productive investment opportunities. Financial systems do not usually operate as desired because lenders confront problems of asymmetric information, which can lead to adverse selection and moral hazard [19].

As for Ukraine, taking part in any economic blocs, the authorities must skilfully use the benefits for economic development. However, authorities should have at its disposal certain levers that would prevent the negative impact of globalization on the national economy development. It should consider:

1. The level of economy development. It mostly depends on the processes that occurred in the past. But equally important is the trend being established in the economic system and which significantly affect the future development of the national economy.

2. The features that characterize the national economy as integrity system. Especially important is stability of the system to the influence of external factors. Largely it will depend on the internal integration of the national economy.

3. Experience of similar economies in the context of globalization. Globalization processes affect differently and have significant features in the development of advanced industrial countries and developing countries.

4. The level of national economies integration to global economic system. Obviously, in determining trends and tendencies of the national levers of economic policy must take into account features of global economic policy.

Conclusions. Based on conducted analysis we can identify the following benefits of globalization for developing and emerging countries: 1. using the experience of economic reforms in other countries for market economic transformation; 2. access to world markets competitive science-consuming products; 3. possibility of fullest usage of international labour division advantage; 4. assistance of international financial institutions in internal problems solving; 5. increasing the availability of funds; 6. improvement of the financial infrastructure.

Among the main risks are the following: 1. financial crises contagion after countries liberalization; 2. fewer options about their monetary policy and exchange rate policy; 3. higher transmission of international interest rates and prices to the domestic economy; 4. degradation of non-competitive industries; 5. unemployment rising; 6. recognition of countries peripheral location in the world, conservation peripheral position; 7. losing of national originality.

Country participation in the processes of globalization must be conditional on economic suitability. Globalization must not destroy the national economy: the interpenetration does not mean destruction and disposal.

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У статті розглянуто основні риси сучасного етапу розвитку світової цивілізації під впливом глобалізації. Виділено ключові переваги і ризики глобалізації для країн, що розвиваються. Проаналізовано стан української економіки у контексті глобалізаційних процесів. Запропоновано важелі зниження негативного впливу процесів глобалізації на розвиток національної економіки.

Ключові слова: глобалізація, світова економіка, національна економіка, економічна інтеграція, країни, що розвиваються.

В статье рассмотрены основные черты современного этапа развития мировой цивилизации под влиянием глобализации. Обнаружены ключевые преимущества и риски глобализации для развивающихся стран. Проанализировано состояние украинской экономики в контексте глобализационных процессов. Предложены рычаги снижения отрицательного влияния процессов глобализации на развитие национальной экономики.

Ключевые слова: глобализация, мировая экономика, национальная экономика, экономическая интеграция, развивающиеся страны.

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